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Politics this week

Jul 15th 2004
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Sincere deceivers

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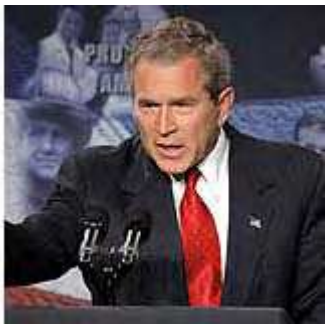

George Bush and Tony Blair said it was right to have invaded **Iraq** even though no weapons of mass destruction have since been found there. Mr Bush was speaking in response to a Senate committee report that severely criticised the CIA and other agencies over the analysis of intelligence on Iraq's weapon ambitions. Britain's prime minister was responding to the Butler report, which accused the government of a collective failure to get the intelligence on Iraq right.

See article

Condoleezza Rice, Mr Bush's national security adviser, insisted that the administration was not planning to delay November's **election** if terrorists attack on or near the day. Her comments came after yet another warning this year from the Department of Homeland Security on possible terrorist targets.

See article

Supporters of a proposed constitutional amendment to ban **gay marriage** suffered a defeat in the Senate. Six Republicans, including John McCain, joined Democrats in a procedural vote that fell way short of the two-thirds majority required to pass a constitutional amendment.

America's agriculture secretary, Ann Veneman, ended a directive that protects almost 60m acres of **national forest** in western states from road building. The states will instead be allowed to submit their own conservation and development proposals for the nature spots to the federal government.

Carrying on regardless (1)

Israel said it would continue to build its security barrier, despite an advisory ruling from the International Court of Justice that it was illegal. But the government said it would move the wall closer to Israel's pre-1967 border to comply with a separate ruling from Israel's own Supreme Court.

See article

Iraq's new government arrested more than 500 people on July 13th, to show its determination to check violent crime. A grenade killed the governor of Mosul and lethal car bombings struck Baghdad and Haditha.

See article

Ashraf Qazi, **Pakistan's** ambassador to the United States, was appointed as the UN's new special representative for Iraq. He replaces Sergio Vieira de Mello, who was murdered in the country in August last year.

Britain's envoy to **Kenya** said that members of its supposedly reformist government “eat like gluttons” and then “vomit all over [the] shoes” of donors. He added that the names of honest ministers and senior civil servants would “fit on a postcard, or possibly a postage stamp”. Kenya asked him to substantiate his allegations, if he could.

Carrying on regardless (2)

AFP

Despite his promises, Silvio Berlusconi, **Italy's** prime minister, did not find a new finance minister. One of his coalition partners deserted to vote with the opposition and dismiss the board of RAI, the state broadcaster, prompting speculation about early elections. Mr Berlusconi defiantly insisted that the government would stay on.

The European Court of Justice ruled that the Council of Ministers had acted improperly in putting the **stability and growth pact**, which limits budget deficits for euro members, into abeyance last November. But miscreant borrowers should still escape sanctions.

See article

President Jacques Chirac announced that France would join other countries in holding a referendum on the **European Union constitution**. The vote will probably take place next year.

See article

French public opinion was horrified by a **racist attack** on a French train, in which a young woman accused of being Jewish apparently had swastikas daubed on her body. But the attack turned out to be a hoax.

The European Commission proposed to scrap **Britain's** rebate from the EU budget, replacing it with a general rebate for all big net contributors. Britain declared that the rebate was “unnegotiable”.

Partial victory

For the first time since 1989, **Japan's** opposition won partial elections for the upper house, with the ruling Liberal Democratic Party collecting only 49 of the 121 seats contested. The LDP-led coalition, however, retains its majority in both houses.

See article

The **Philippines** announced that it is withdrawing its 50 or so troops from Iraq after the kidnapping of one of its citizens in the country. The small Filipino contingent was originally supposed to go home on August 20th.

See article

The 15th International Conference on **AIDS** took place in Bangkok. Delegates welcomed an increase in funding to combat the disease but disagreed over how to spend the money most effectively. Politics, rather than science, dominated the discussions.

See article

Afghanistan's electoral commission announced dates for the country's oft-delayed elections. The presidential election is now set for October 9th, though Afghans will have to wait until April to elect local and national assemblies. A poll showed that 81% of Afghans planned to vote in the election, and that 77% thought the elections would “make a difference”.

Torrential monsoon rains hit **South Asia**, causing what was described as the worst floods in over a decade, affecting over 10m people in India, Bangladesh and Nepal.

Not in the running

Marta Sahagún, the wife of **Mexico's** president, Vicente Fox, said she would not be a candidate in the

next presidential election in 2006. Earlier this month, Mr Fox's chief adviser resigned, blaming the political ambitions of Ms Sahagún for poisoning her husband's term.

See article

Peru's largest trade union confederation held a one-day general strike, the first in five years, in protest at the government's economic policies. In Lima, about half of public transport continued to operate. Meanwhile, thousands of passengers were stranded for two days when the country's largest domestic airline was grounded after its insurance was cancelled. The United States accuses its owner, Fernando Zevallos, of drug-trafficking; he denies it.

AFP

Alberta's Conservative premier, Ralph Klein, announced that he would pay off his province's outstanding public debt. Alberta thus becomes **Canada's** only debt-free province; the others can only envy its oil and gas royalties.

See article

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Business this week

Jul 15th 2004
From The Economist print edition

Coming together

UFJ, Japan's fourth-largest bank, said that it was seeking a merger with **Mitsubishi Tokyo Financial Group**, the country's second-largest, that could end in the creation of the world's biggest bank by assets, surpassing Mizuho, another Japanese institution. Struggling UFJ had planned to sell some operations to Sumitomo Trust & Banking Company to raise cash, but scrapped the deal, prompting a threat of legal action.

See article

Morgan Stanley paid $54m to settle a sex-discrimination lawsuit alleging that female employees at the Wall Street giant's equities arm were denied promotion and persistently groped. A former bond trader won $12m, the bank will set up a fund of $40m to compensate some 300 other aggrieved employees and the rest will go towards beefing up the bank's anti-discrimination policies.

See article

America's Securities and Exchange Commission voted 3-2 in favour of greater oversight of **hedge funds**. If adopted, the new rules will require hedge-fund advisers to register with the commission.

See article

Diamond geezers

De Beers agreed to plead guilty to price-fixing charges that have hung over it in America for ten years. The diamond cartel will pay $10m to settle accusations that it conspired with General Electric to fix industrial-diamond prices. Top executives of the firm may now travel to America without fear of arrest and De Beers will be able to operate directly in the country.

See article

Yukos's hopes of paying a $3.4 billion bill for back taxes receded after a court seized just under half of its 35% stake in a rival, Sibneft. The Russian oil firm had hoped to sell the stake to finance a deal with the Russian government to pay over $8 billion in back taxes over two years. Earlier, Mikhail Khodorkovsky, on trial for fraud and tax evasion, offered his shares in Yukos to offset the bill.

More trouble for **Royal Dutch/Shell.** Its external auditors were reportedly alerted to potential problems with its reserve-allocation system in 2002, long before public disclosure led to resignations and embarrassment this year. The oil giant is still struggling to restore its reputation.

Philip Morris agreed to make a “voluntary payment” of up to $1.25 billion over 12 years to settle a long-running dispute with the European Union. The tobacco giant is accused of conspiring to assist smuggling by oversupplying cigarettes to a number of low-tax countries that were then resold on the black market in high-tax regions. Other cigarette firms may have to make similarly enormous settlements.

Marks & Spencer fought off the attentions of Philip Green, a rival retailer who wanted to buy the struggling British retailer. Mr Green's £9.1 billion ($16.9 billion) offer was rejected by M&S management, which promised to return £2.3 billion to investors through a share buy-back and the sale of its financing

arm for £762m. Mr Green complained that he was treated “with contempt”.

See article

Bad hat

Red Hat, the world's largest distributor of Linux, an open-source operating system for computers, said that it would restate its results for the past three years and admitted that the Securities and Exchange Commission was investigating its accounts. Red Hat's shares plunged by over 20%.

Intel's shares tumbled despite profits nearly doubling in the latest quarter compared with a year ago, to $1.8 billion. The world's biggest chipmaker cut its forecast of profit margins and said that inventories were rising, stirring fears that the tentative recovery in tech spending is stalling.

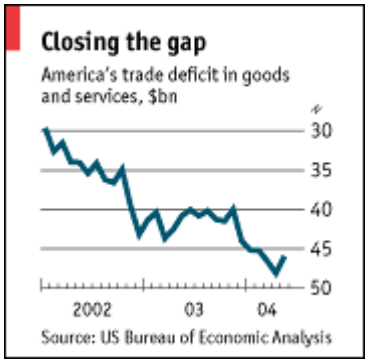
However, **Philips Electronics** reported that profits in the latest quarter had jumped to *euro*616m ($742m) compared with $42m a year ago, partly attributable to a surging demand for chips, particularly those used in mobile phones.

NASDAQ may never again experience the heady days of the 1990s boom. But Google's choosing to list on America's tech-heavy exchange after its $2.7 billion initial public offering is a boon for NASDAQ, which fought off strong competition from the New York Stock Exchange.

Reed Elsevier announced that it would pay $775m for Seisint, an American company specialising in providing information to improve risk-management decisions. The Anglo-Dutch media giant, which provides a similar service, is keen to expand the business in America.

The deficit shrinks

America's trade deficit narrowed in May for the first time in six months, to $46 billion after hitting a record $48.1 billion in April. A weakening dollar boosted exports, but America's insatiable appetite for foreign goods ensured that the value of imports grew.



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Bush, Blair and WMD

Sincere deceivers

Jul 15th 2004
From The Economist print edition

They believed what they said, but they said more than they really knew

Get article background

GRANDMOTHERS through the ages have advised that honesty is the best policy. Politicians are not known for taking grandmothers' advice, but George Bush and Tony Blair must now wish that they had. In making the case for last year's invasion of Iraq, they were honest about what they believed, namely that Saddam Hussein was a dangerous man, was likely to possess the world's most dangerous weapons, and had been too deceitful in the past decade to be trusted in the new atmosphere following September 11th. But, as critical reports last week from the Senate Intelligence Committee and this week from Britain's Butler committee showed, the American and British governments were not honest about how solid their knowledge really was (see article). When making the case for war, in effect they gambled that the facts found in Iraq would bear out their claims. They haven't. The result is not only damage to the personal credibility of America's president and Britain's prime minister. It is real damage to the ability of those countries, and probably others, to deal with future military and terrorist threats.

Both Mr Bush and Mr Blair do often say honest, sensible things about Iraq. This week, responding to the Senate committee's report, Mr Bush made an admirable speech explaining why he went to war. Despite the uncertainties about what his spies knew, a responsible American president could not, he said, take the risk, after September 11th, of leaving Mr Hussein with weapons of mass destruction to use himself or to offer to terrorists, who might now be seeking an even bigger attack on a newly vulnerable America. Nor was continuation of the containment regime, using sanctions and bombing raids from Saudi bases, a sustainable alternative. Mr Blair made a similar, strong case in his speech to Parliament on July 14th, in response to the Butler report. As he said, there is now criticism that the Bush administration did not seize upon the frail intelligence it had to stop the September 11th attacks, yet also criticism that stronger—but still frail—intelligence led to the decision to invade Iraq. How would he have been judged, he asked, if an Iraqi or Iraqi-assisted attack had taken place after he had shrunk back from the issue?

What a pity that before the war neither the British nor the American governments stuck to such careful justifications. Instead, they went much further, turning legitimate suspicions into hard facts. Mr Bush's vice-president, Dick Cheney, was especially reckless when declaring as incontrovertible truth that Mr Hussein had resumed his nuclear-weapons programme. His secretary of state, Colin Powell, made a speech to the UN Security Council in February 2003 that seemed thin at the time but has now been shown by the Senate Intelligence Committee to have included many claims made with an authoritativeness not justified even by what was known then. And Mr Blair's public “dossiers” on Iraq's WMD made statements that stripped all the caveats from intelligence assessments, turning dangerous possibilities into seemingly clear realities.

Given the long—some would say interminable—debate over Iraq in 2002-03, and given widespread public and international scepticism about whether war was the right solution, such salesmanship was understandable. As Mr Bush's predecessor, Bill Clinton, has said, the spies' briefings about Iraq were consistent for many years, and September 11th did change the way in which a president had to view them. To understand, however, is not to forgive. For hyped-up salesmanship brings clear consequences: customers become even more sceptical, once they find they have been gulled. The basic claim made by Mr Bush and Mr Blair is true: we do live in dangerous times, in which the threat of catastrophic attack by WMD-armed terrorists is real. But the next time politicians call for military action to deal with such

threats, on the basis of intelligence warnings, even more people will refuse to believe them. Well-intentioned or not, such salesmanship has made us all less safe, and more vulnerable to terrorists.

Holding them to account

Has it made their own jobs less safe? In Tony Blair's case the answer is: probably not, for now. The great risk to him in the Butler report was that the committee might find that he had included things in his WMD dossiers that he knew at the time to be untrue. It didn't. Had it done so, an already wobbly Labour Party might have decided that their great election-winner had become an electoral liability. Still, as *The Economist* went to press, voters in two by-elections had the chance to offer an immediate verdict on the Butler report.

Whatever fuss that verdict stirs up, however, Labour minds are likely to focus on two other points: that, despite all that has happened in Iraq, Mr Blair's party remains ahead in national opinion polls; and that to switch now to Gordon Brown, probably less than a year before a general election, would be to take an unnecessary risk. Britain's chancellor of the exchequer can boast of the country's stable economic growth and of all the extra money he has been pouring into public services (see article), without threatening that stability. Yet Mr Brown is an uncompelling election-campaigner and has a leadership style that is divisive and confrontational, to say the least. Moreover, there is time before the election for the situation in Iraq to improve sufficiently to make it a less important and emotive issue when Britons eventually vote.

There is much less time for such improvement before Mr Bush must meet his electoral makers. Another deadly car bomb in Baghdad this week offered a reminder, if one was needed, that it will be perilously hard for him to make confident claims that things are on the mend there, even if they are. The latest *Economist*/YouGov poll finds that over 60% of Americans polled think they were given false information about Iraq's WMD and 52% disapprove of Mr Bush's handling of his presidency. By the time they vote on November 2nd, Mr Bush will have to convince millions of Americans that he is more trustworthy than his record makes him look, or else that to elect his opponent would be too risky to contemplate.

Mr Bush has said that he is running as a war president, which is not surprising given that he has fought two of them in the past four years. This newspaper supported both wars, the second of them pretty much on the basis that he outlined in his speech this week. We still think it would have been riskier to carry on containing Saddam, a policy by then both counter-productive and weakening, than to remove him from power. Yet though that invasion made possible a stabler, more prosperous Iraq, despite all the ensuing turbulence, Mr Bush still needs to bear the responsibility for having made things harder and more dangerous in several ways. One is the dishonesty already outlined, and its consequence for public trust. Another is his failure to deal with the abuses at Abu Ghraib prison by demanding accountability at a senior level, preferably by requiring the resignation of Donald Rumsfeld, his defence secretary. A third is the negligent lack of preparation and initial resource-provision for rebuilding Iraq.

Not everything goes right during war, or military occupation, to put it mildly. Intelligence is always uncertain, and often looks comically or outrageously wrong in retrospect. Decisions have to be made in a fog, on a balance of risks, in an atmosphere of doubt. Yet when things go plainly wrong, errors need to be admitted to and senior people held to account. Having failed to hold others to account over Iraq, Mr Bush now has a lot to do to convince the electorate—and *The Economist*—that the buck should not in fact stop with him.

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Israel and the Palestinians

The wall and the law

Jul 15th 2004
From The Economist print edition

The International Court of Justice finds against Israel's "security barrier". What now?

Reuters

Get article background

LAWYERS sometimes mince their words. That is an accusation nobody can level at the judges of the International Court of Justice in The Hague after last week's ruling that the fence Israel is building in the West Bank violates international law. They said that the wall should be torn down and that Israel should compensate the Palestinians for the disruption it has caused. However, the court is allowed to issue advisory opinions only, not binding ones, and this is a piece of advice that Israel's prime minister, Ariel Sharon, also no mincer of words, says he intends to ignore. Israel will continue to build what it prefers to call its "barrier" (it is a wall in some places, a system of fences in most), on the grounds that it helps Israel to defend itself against Palestinian suicide-bombers.

The court rules; Israel carries on regardless. So is that the end of the story? And should it be? To the first question the answer is no. The Palestinians see this ruling as a political and moral victory as well as a legal one, and intend to move the story on. The UN General Assembly, which against the advice of most of the big powers referred the question to the court in the first place, was due to meet on July 16th to decide its next step. At some point—probably after November, when the Palestinians hope to find a friendlier face in the White House—the assembly is likely to send a resolution to the Security Council, which is the only UN body that has the power to order Israel to comply with the court's wishes and apply sanctions if it does not. The Americans may then find themselves facing that second question, along with a familiar dilemma. Should it use its veto to defend its ally, or allow the Security Council to punish Israel for its illegal activities? That depends.

A land grab, but it saves lives too

If the court's ruling has a defect, it is its curiously brusque disposal of Israel's claim that it needs the barrier for self-defence. The Palestinian suicide-bombings against which Israel says it is building its wall are scarcely mentioned in its verdict. But the rest of the court's argument is straightforward enough.

The Security Council has said time and again that the settlements Israel has built on the lands it captured in the war of 1967 are illegal, as was its annexation of the eastern, Arab, half of Jerusalem. The court seems to argue, by extension, that Israel is entitled to build a fence on its own side of the armistice line that separated Israel from Jordan before that war, but not one that extends into the West Bank to protect some 160,000 Israelis (not counting those in east Jerusalem) who have been allowed and often encouraged to settle, illegally, on the far side. Such a fence, the court says, could well become permanent: like the settlements themselves, it can be construed as an attempt to create facts on the ground, change the demography, attach parts of the West Bank to Israel and so impede the Palestinians' quest for a state of their own.

If the settlements are illegal, and the wall that protects them is therefore illegal, why not dismantle not just the wall but the settlements too? That is just what the Palestinians want. The trouble is that the law cannot be the last word in conflicts such as this. The settlements should indeed never have been built. Israel's colonisation of the West Bank and Gaza after 1967 was a misbegotten venture that has—

deliberately—made it very much harder to negotiate a peace based on sharing the disputed land between two states. But what has been done over nearly 40 years is not so easily undone.

It is almost inconceivable now that an Israeli government could survive the upheaval entailed by a return to the borders of 1967, or that America would expect it to. The diplomacy now is focusing on something closer to the deal Bill Clinton tried to broker: Israel out of Gaza and most of the West Bank, but keeping some of the areas close to the 1967 line where the bulk of the settlers live. It seems unfair to the Palestinians, but they and the Arab states share some of the blame: Israel would probably not be in the West Bank and Gaza at all but for the Arab refusal for so many years before and after 1967 to accept a Jewish state in any corner of historic Palestine.

So what should the Security Council do when it receives the expected resolution from the General Assembly? That depends. If by then Israel is moving towards the two-state solution that Mr Sharon claims these days to believe in, the right answer may be nothing. But if by then it is Israel that is obstructing progress, there may be a case for censure and even sanctions. The law cannot take the place of negotiation in resolving this conflict. But it does have a role, not least in helping to remedy the imbalance between the strong and weak.

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Hedge funds

Too stern a hand

Jul 15th 2004
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America's regulators already have sufficient oversight of hedge funds

Get article background

RICH, secretive, risky and growing recklessly: hedge funds are a mighty temptation for regulators. America's Securities and Exchange Commission (SEC) has succumbed at last. On July 14th it voted, by 3-2, to propose a rule requiring hedge-fund managers to register with the commission under the terms of the 1940 Investment Advisers Act. That would subject them to auditing and disclosure requirements. A final vote could come later this year, following a period of hot debate.

The SEC is worried about the hedge-fund industry's astounding growth. Five years ago such funds were truly an alternative investment class, reserved mostly for the very rich. If billionaires got snookered, who cared? Today, while the sector remains closed to those of middling means, pension funds—responsible for the retirement assets of ordinary people—are diversifying into it in a big way, believing they can earn good returns. They may be sadly mistaken (see article).

The move on hedge funds is part of a rush of regulatory activity. Corporate wrongdoing and scandals in the mutual-fund industry are to blame. Eliot Spitzer, New York's attorney-general, has been in the vanguard. Now, rather belatedly, the SEC seems bent on a crackdown of its own.

On the face of it, the proposal for hedge funds seems mild enough. If adopted, funds would merely have to publish information on fees and managers' conflicts of interest, and be subject to spot audits by the SEC. That could deter, say, the theft of clients' money or the deliberate exaggeration of assets or performance. Since 1999 the SEC has pursued 46 probes into such activities by hedge funds. Bad behaviour could increase as managers grow desperate in the face of falling margins and more competition.

However, requiring registration of hedge-fund managers is unnecessary. Up to half of them have already signed up voluntarily to the 1940 act, according both to the SEC itself and to industry estimates. Pension funds and endowments have spurred this. They may foolishly be pumping money into an overblown industry that charges outrageous fees, but they are at least covering their backs by pressuring managers to demonstrate that they are reputable. And investors with unregistered fund managers already have the right to ask extra questions if they have concerns.

Given that the industry is already sorting itself out, the rules would do harm, not good. One worry is that the commission, like regulators the world over, is over-stretched despite a recent hiring spree. It would struggle to oversee the masses of funds, let alone to value properly what are often highly complex trading positions. But the real concern is that regulation is a slippery slope. Just look at America's mutual funds, which are now in a regulatory straitjacket that is costing investors a fortune in compliance charges.

Hedge funds should not have to share that fate. So thinks Alan Greenspan, chairman of the Federal Reserve, who told a Senate committee in February that hedge funds are “very significant” to liquidity, and warned that any regulation could escalate uncomfortably. The SEC may not be deterred. It would like to know more about hedge funds, and knowing may not lead to liking, especially with the memory of Long-Term Capital Management, a massively leveraged hedge fund that had to be bailed out in 1998, still potent. The Senate banking committee was discussing hedge-fund regulation this week. If it were to

decide to check the SEC's enthusiasm, so much the better.

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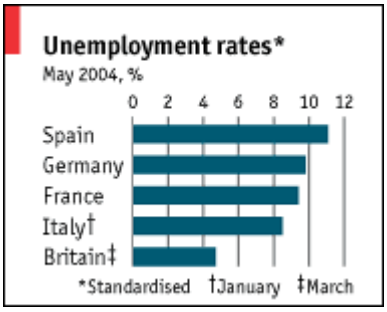
About sponsorship

Labour markets in Europe

Thirty-five hours of misery

Jul 15th 2004
From The Economist print edition

Europe wakes up to the folly of excessive labour-market regulation



IT WAS a moment of triumph for France's Socialist Party. Four years ago, the government of Lionel Jospin, taking advantage of a spurt of French economic growth, brought in their long-promised 35-hour week. The idea was to reward France's highly productive workers by awarding them shorter hours, but with the same high pay. The Socialist government also promised that, because the measure would share out the available work, it would create more jobs, cutting France's persistently high unemployment. Thus could the European social model be made consistent with a new economic dynamism.

Today the triumph is tarnished. The French economy, like other big euro-area economies, has performed badly in the past few years, and unemployment has remained high. French businessmen, hopeful at first that the 35-hour week might help push through other productivity-enhancing changes, now complain that it has added extra rigidities and raised costs. The 35-hour week's main sponsor, Martine Aubry, has lost credibility even within the Socialist Party. In his Bastille day message this week, President Jacques Chirac put the emphasis on getting the economy growing again, not on protecting the social model. His finance minister, Nicolas Sarkozy, makes few bones about wanting to move away from the 35-hour week (see article).

Symbolically significant as it became in its own terms, the 35-hour week was also part of a wider European approach to sclerotic labour markets that can now be seen to have comprehensively failed. In many countries besides France, the cure for high unemployment has been sought in the encouragement of shorter working hours. Another common response to growing insecurity about jobs has been to increase job protection and make it harder to fire people. And a widespread reaction to growing global competition that has lowered pay at the bottom end of the market has been to entrench high minimum wages.

As many pointed out at the time, these measures made little sense. The notion that there is a fixed amount of work to be shared out, so that shorter hours for all must mean more jobs, is widely derided by economists as the “lump of labour” fallacy. Making it harder to fire people serves mainly to discourage hiring them in the first place. And high minimum wages translate not into better-paid workers but into more people without jobs. These observations are no longer just matters of theory: the recent experience of France, Germany and other continental European countries shows that they apply in practice too. As the OECD's recent *Employment Outlook* noted, the empirical evidence points to a clear correlation between high levels of job protection and high levels of unemployment.

Belatedly, Europe's governments are realising this, and coming round to the need to free up their labour markets, not tie them down in even more red tape. Indeed, they have begun to grasp that excessive regulation of labour markets, far from being a sensible response to slower growth, is actually a significant cause of it. Deregulating labour markets need not mean sacrificing all the protections of Europe's social model: countries such as Denmark, Finland and the Netherlands have shown that generous welfare systems and a strong safety net can be preserved even while allowing market forces to play more freely in the demand and supply of labour.

That does not mean that trade unions and other vested interests will be happy. They are already fighting to keep job-protection measures, since these benefit those already in work at the expense of those looking for work. But workers themselves are now accepting the case for change. In France, a majority even say they would junk the 35-hour week if it enabled them to earn more. The drumbeat for reform in

Europe grows ever louder. Wise governments will heed it.

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Trade

Talking the talk

Jul 15th 2004
From The Economist print edition

Don't blame the rich world if trade talks collapse again

Get article background

AP

WHEN global trade talks broke down in Cancún last September, many commentators—including this newspaper—worried that they would be hard to resurrect. America would be too distracted by its presidential election and the European Union too preoccupied with its new members to bother with tricky negotiations whose main purpose was to help the world's poor. In fact, the elephants of world trade have shown a remarkable dedication to the Doha round over the past ten months. It is the minnows—the world's poorest countries—that have been threatening to kill any deal.

Crunch-time comes at the end of this month when trade ministers meet in Geneva. At issue is whether they can agree on a “framework” for how to conduct the trade talks. Success on that front would not mark the end of tough negotiations; the trade talks would still have a long way to go. But if the Geneva talks do end in failure, then the prospects for the Doha Round, at least in its current form, are bleak.

The good news is that the world's big traders, both rich and poor, have a deal within their grasp. The EU has given up on ambitions to expand the Doha agenda to new areas, such as investment. It now wants new negotiations only on rules for trade facilitation, simplifying paperwork and reducing corruption. No one, except perhaps the politicians who benefit from corruption, should object to that.

On farm trade, the giants (America, the EU, Brazil, Australia and India) are inching towards compromise. It will not be a perfect outcome. Laudable boldness, such as the EU's willingness, despite French opposition, to eliminate export subsidies on farm products, will be tarnished by lamentable timidity, especially on tariff-cutting. There are still potential flash-points. But the skeleton of a global farm-trade deal certainly exists.

Even a farm breakthrough might not put the talks back on track. For the poorest and smallest have been talking tough, particularly African and Caribbean countries. Since the WTO works by consensus, any one of them could block a deal.

The demands of the smaller countries are disparate and often hard to pin down. Some want the rich world's cotton subsidies treated as a special issue, outside general agriculture negotiations. Poor countries with preferential access to rich-world markets want to make sure that freer trade will not reduce those preferences. If it does, many want cash compensation. Some of them plainly do not want the Doha round to succeed. Many sugar and banana producers in the Caribbean, for instance, reckon they are better off with preferential access in a distorted system.

Freedom, not preferences

This logic is misguided and shortsighted. Trade preferences are no route to long-term prosperity. Evidence that they help at all is decidedly mixed. And since these preferences are granted unilaterally by rich countries, they can easily be removed or rendered redundant by other policy changes. The EU's upcoming reform of its sugar system, for instance, will erode many of the Caribbean countries' preferences, regardless of the outcome of the trade talks.

Good sense may yet prevail. At a meeting in Mauritius this week, the poorest countries showed signs of becoming more flexible. But even if they do now derail the Doha round, a few small, poor countries will not hold the global trade agenda hostage indefinitely. Eventually the Geneva negotiators will have to find a way of bypassing the recalcitrant poor countries; or global talks will give way to more regional and bilateral deals. Either way, the biggest losers would be the poor people that the Doha Round was designed to help.

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Letters

Jul 15th 2004
From The Economist print edition

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Moore to add

SIR – Lexington skips too lightly over Michael Moore's most fundamental contribution to the debate about American military adventurism: the complete lack of participation by America's conservative elite (July 3rd). This is an historical anomaly in the business of empires. It is extraordinary how risk-averse the current leadership of the Republican Party is in these matters. Go through their backgrounds and you will find few who have served in the military. Indeed, it appears that more leading Democrats have served in the armed forces than have Republicans. When bellicose leaders ask your children to fight wars in foreign lands but refuse to send their own that says something.

C. Rowley
Ellenville, New York

SIR – You say that "Fahrenheit 9/11" is potentially dangerous to Democrats in "middle America". This is at odds with the success of the film in both liberal and conservative strongholds. Mr Moore's basic insight, that American political culture is nationalistic but not imperialistic, may contribute more to the film's poignancy and appeal than his controversial claims that are the subject of so much debate.

Christopher Greenwald
Chicago

SIR – Informed decisions are based on evidence or at least assertion, rather than cheap innuendo. If Mr Moore truly intends to sway voters, he must not think very highly of their intelligence. Sadly, the reception of his film is proving him right.

Jerry Tempelman
Jacksonville Beach, Florida

Communists in check

SIR – Democracy in the Czech Republic is alive and well ("One more defenestration", July 3rd). While the Communists may have won 20% of the votes cast in June's European election, this accounts for only 6% of eligible voters. When the Communists finally decide to renounce all the horrors of the previous era, they may then become more acceptable as coalition partners. Until that time, Czech parties are free to choose mainstream partners that reflect mainstream views, and the wishes of the people. That is the essence of democracy.

Bill Eldridge
Prague

Top-up reform

SIR – If an education-voucher scheme were put in place that allowed top-ups, a simple way for working-class parents to save the extra money needed to send their children to private school would be for those that smoke to give up the habit ("Not just for the posh", July 3rd). Parents have always sacrificed, scrimped and saved for the benefit of their offspring. Instituting a voucher scheme that does not allow for top-ups fails to recognise the fundamental drive of parents and will simply arouse their ire by dangling a

desirable yet unobtainable carrot before their eyes, though admittedly a little closer. The Tory policy will preserve elitism for the elite as usual and attract opportunists rather than educationalists.

Kathrin Hamilton
Edinburgh

Case for the defence

SIR – Bagehot says that Britain's Ministry of Defence is “not taking a sharp enough axe to procurement programmes conceived during the cold war” and mentions the ministry's “fashionable obsession” with America (July 10th). I would like to correct the record. If Typhoon was only “designed to win air superiority in Europe” it would be an “over-sophisticated anachronism”. But this is not the case. Typhoon will be an agile multi-role fighter that will serve as the cornerstone of the RAF's future fighting capability. It will replace two single-role types providing both improved operational flexibility and cost savings. The RAF has taken delivery of seven aircraft and is delighted with its performance.

As technology develops, it becomes even more important that we, and our NATO partners, invest in the capabilities that enable us to operate alongside America. We are actively encouraging this with an emphasis on flexible, deployable, and technologically advanced and interoperable forces. However, I accept that while technology will make our forces yet more effective it will not replace the value of “boots on the ground”. Peace-support operations, for which British armed forces already—and rightly—have an unparalleled reputation, are a very good example of this.

Willy Bach
Minister for defence procurement
London

Pay-back time

SIR – Carlos Perez argues that holders of high-interest Argentinian bonds knew the risks of default were high and do not deserve their money back (Letters, July 3rd). This is outrageous. Millions of ordinary Argentines are on the verge of losing their savings because Argentine politicians were irresponsible and the IMF was too weak. It is not feasible to “attract back” offshore savings as the equity market is too small. An economic recovery based on not paying debts is an illusion. Managing the debt and paying it off may take time but it is better this way than resorting to populism.

David Hutchinson
Barcelona

SIR – The figure of 30,000 “missing” in your survey on Argentina does not match the official figure estimated by the ad hoc commission set up by the democratic government that prosecuted and imprisoned most of the senior members of the military regime it succeeded in 1983 (June 5th). It is equally bad if the *desaparecidos* numbered 30,000 or 8,960 (the official figure), but the propagation of this sort of erroneous information will not help the much needed reconciliation in a battered society.

S. Risso-Patron
Caversham, Berkshire

A grey area

SIR – The proposition that a large informal or “grey” economy contributes to a lower growth rate is false (Economics focus, June 19th). The study you cite ignores the many workers employed in the grey economy who would not otherwise be employed if it did not exist. If not for the grey economy, these workers would be dependent on welfare and state subsidies, which would drag down growth even more. Furthermore, the only losers from the grey economy seem to be economists, and of course tax collectors, whose morass of regulations and over-taxation create it to begin with.

Vijay Rao
Los Angeles

Ladies of the night-off

SIR – You note that call girls are being drawn from far and wide to service America's political conventions ("On the trail", July 3rd). While standing in line to register for an American Economic Association annual meeting some years ago, I overheard someone remark that the prostitutes of New Orleans look forward to the arrival of economists in town. While glancing at my colleagues in their ill-fitting suits and dragging cardboard suitcases, I heard the following clarification: "It's their opportunity to take a week off."

Robin Watson
Berlin

ONLINE ARTICLES

The following correspondence refers to articles published only online

Security barrier

SIR - Israel's security barrier will reduce Palestinian hardships in the long term, by stopping terrorism and creating conditions for peace ("Israel's illegal but unstoppable barrier", Economist.com, July 9th). There will be no peace until terror ends, and terror won't end until there is barrier. Palestinians say the barrier encroaches on their future state; but there will be no state until the terror stops, and measures short of a barrier have failed to stop the killing. Having failed to stop the terror themselves, Palestinians must accept the barrier as a necessary hardship on the road to a state.

Ilya Shlyakhter
Brighton, Massachusetts

Who's disappointed?

SIR - You say that, in his stint as president of the European Commission, Romano Prodi "has largely disappointed" ("The summit of all fears", Economist.com, June 16th). I would argue instead that he has been disappointed. Mr Prodi and his coalition engineered a remarkably productive period in Italian politics between 1996 and 1999, putting Italy squarely on the European map through hard work. And surely his national success, intelligence, resourcefulness and political acumen should have been more than sufficient to do ever greater things in Brussels. But he discovered very early on in his tenure that the puppetmasters of Europe, France and Germany, are uninterested in initiatives and perspectives originating in other parts of the continent. Those who criticize Mr Prodi on his way out of office should also acknowledge France and Germany's discomfort with the idea that anyone else but they should have a significant say in Europe's future.

Mr Prodi's disillusionment with the pan-European scene prompted him to campaign for the Italian centre-left in the recent European Parliament elections. In Italy, at long last, he has the opportunity to once again employ his talents, this time in the noble cause of felling the disastrous Berlusconi-led government. Forza Romano!

Alberto Prieto
Austin, Texas

Chaos in Iraq

SIR - You say that "the insurgents have done everything they can to ensure this is so, in particular by destroying the economic infrastructure that could create growth, such as oil pipelines" ("Violence, chaos and the Saddam show", Economist.com, July 5th). I am shocked that you would blame insurgents for the economic and social problems in Iraq. How quickly you forget the years of sanctions and a power vacuum left by an inadequate and impotent occupation.

Sarah Yassien
Sydney

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Intelligence failures

The weapons that weren't

Jul 15th 2004
From The Economist print edition

How the Americans and British got it all so wrong

Get article background

ON THE evening of July 11th, George Tenet lit a fat cigar and loitered in the compound of the Central Intelligence Agency in Langley, Virginia. His last hours as America's spy chief were passing painfully. According to the Senate Intelligence Committee, in a report released two days earlier, America invaded Iraq on the strength of intelligence that was out-of-date, inaccurate, badly analysed and, in short, did not justify the nub of George Bush's case for war.

America did not, as Mr Bush had claimed, have conclusive evidence that Iraq had retained and replenished its chemical and biological weapons, or that it was reactivating its nuclear programme. Nor, from any angle, could the agency find an alliance between Saddam and al-Qaeda. Mr Tenet was seen to pause by a garden feature: a hefty slab of the Berlin Wall. Perhaps the CIA's failure to predict the Soviet Union's collapse seemed suddenly less burdensome. On that, the agency was merely short-sighted. On Iraq, it appears to have been hallucinating.

Mr Tenet's decision to resign “for personal reasons” last month now looks wise. His farewell party was held on the eve of the report's release. But for John Scarlett, the best known British spy, the price of failure seems to be promotion. On July 14th, a British inquiry into intelligence on Iraq's putative weapons of mass destruction (WMD), headed by Lord Butler, a former top civil servant, delivered a broadly similar verdict to the Senate committee's, but in a kindlier tone. Where the senators' report barely contained their dismay at the CIA's ineptitude, his lordship's criticism was more of a finger-wagging, with much talk of collective responsibility.

Mr Scarlett, the newly appointed head of Britain's Secret Intelligence Service (known as MI6) and former head of the Joint Intelligence Committee (JIC), was one of the few officials named in the report. In his old role, Mr Scarlett was responsible for the government's “dossier” on Iraq's WMD, published in September 2002, which has proved to be misleading and substantially false. There have been calls for Mr Scarlett's head, which Lord Butler urged the government to ignore.

The British agency's record on Iraq does withstand scrutiny a bit better than that of its American counterparts. The Senate found that the flotilla of intelligence agencies under Mr Tenet, the director of central intelligence, were gullible and incompetent, reflecting a “broken corporate culture and poor management”. They had no agents in Iraq since 1998, and even before then relied heavily on information supplied by UN weapons inspectors (some of whom were moonlighting as spies). By

September 2002, when the agencies were told to draft a National Intelligence Estimate (NIE) of Iraq's weapons of mass destruction, which were a key exhibit in Mr Bush's case for war, most of what they "knew" about weapons programmes pre-dated the first Gulf war in 1991.

MI6 did have five agents inside Iraq, but they seem hardly to have improved its intelligence. According to Lord Butler, only two of those agents were wholly reliable; their assessments of Iraq's WMD capabilities were "less worrying than the rest". Intriguingly, Lord Butler notes that intelligence obtained from another agency on Iraq's biological weapons was withdrawn after it was found to be seriously flawed, owing to "misunderstandings".

Making the most of a hard case

In the autumn of 2002, British and American intelligence services found themselves in a similar fix. For years, they, like every other western intelligence service, had advised their governments that Iraq's WMD programmes were a persistent menace. Now, they were being instructed to make that case fully and publicly, and suddenly it didn't look quite such a "slam-dunk," as Mr Tenet is said to have described it.

This was for two reasons. First, spies rarely produce the sort of clinching evidence beloved of investigative journalists and fictional detectives. Intelligence tends to be fragmentary and accretive. It does not lend itself to Powerpoint presentations. Second, due to the difficulties of operating in Iraq and their own deficiencies, both services were pitifully wanting in good current intelligence. In addition, the CIA's job was made especially difficult by Mr Bush and his more warlike followers. They were already making fiery claims about Saddam Hussein and his alleged alliance with al-Qaeda which the agency was unable to substantiate.

Nonetheless, the CIA tried not to disappoint. Into the NIE, according to the Senate report, went a shower of dodgily-sourced and overstretched intelligence. In the estimate's declassified version, possibles became probables, and caveats were cut, as scraps of potentially alarming intelligence emerged as terrifying facts.

Numerous qualifiers—"we judge that", "most analysts believe that"—were excised. Thus were reasonable, though wrong, intelligence suppositions reborn as erroneous facts. To the (now discredited) claim that Iraq was developing its ability to deliver biological weapons was attached the dread phrase, "including potentially against the US homeland."

They were being instructed to make that case fully and publicly, and suddenly it didn't look quite such a "slam-dunk"

Much of the intelligence used in the British dossier was also denuded of important qualifiers. This was "a serious weakness", according to Lord Butler, which put more weight "on the intelligence than it could bear". In a perverse example of this, an original statement that the JIC had little information about Iraq's WMD programmes since 1998, was rewritten to suggest that the resulting uncertainty was itself a cause for suspicion. Lord Butler found that the dossier's judgments "went to (although not beyond) the outer limits of the intelligence available."

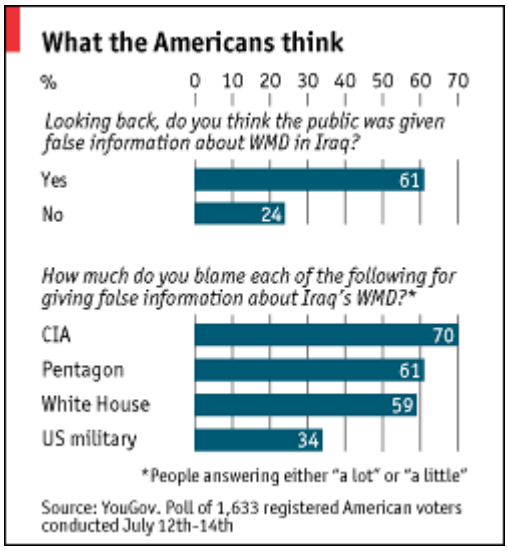
Mr Powell's smoking guns

In February 2003, Colin Powell, the secretary of state, delivered a presentation to the UN Security Council that has been credited with convincing many sceptics of the case for war. Mr Powell outlined "many smoking guns" in Iraq, including a fleet of mobile biological weapons laboratories. All of these, he said, had been identified with the use of solid intelligence, corroborated by multiple sources. But the Senate committee found otherwise.

Shortly before Mr Powell delivered his speech, a CIA agent read a draft version of it, and reacted with horror. According to e-mails provided to the committee, the agent identified himself as being the only American agent to have interviewed the main source behind the mobile-lab intelligence. He considered the source, codenamed Curve Ball, an unreliable drunkard whose identity was not yet established. Three additional sources who were supposed to have corroborated Curve Ball's claims were either known "fabricators" or had not, in fact, corroborated the claims at all. In reply to these concerns, the agent was told by a senior CIA official: "Let's keep in mind the fact that this war's going to happen regardless of what Curve Ball said or didn't say, and that the Powers That Be probably aren't terribly interested in

whether Curve Ball knows what he's talking about."

Similarly slapdash, the British dossier contained the hair-raising claim that Iraq could deploy WMD in a mere 45 minutes. This triggered apocalyptic newspaper headlines across the country. "Brits 45 mins from Doom," screamed the *Sun*, a popular British tabloid.



The dubiousness of the 45-minute claim (which, it later emerged, applied only to battlefield weapons) has dominated several earlier inquiries into Britain's pre-war intelligence. Hours before Lord Butler's report was released, Iraq's new prime minister, Ayad Allawi, sheepishly told the BBC that his émigré group was behind the claim. Speculation lingers that Mr Allawi's supporters lifted it from the user-guide for a Soviet missile. Lord Butler said that it should not have appeared in the form it did in the dossier.

Both the American and British reports put the agencies' mistakes down to incompetence, not intent. Though consistently wrong on almost every count where Iraq's WMD were concerned, the spies apparently thought they were right. Lord Butler attributes this partly to the fact that Mr Hussein had made fools of the spies often before. There was, he said, "a tendency for assessments to be coloured by over-reaction to previous errors," ensuring that the worst-case scenario ruled.

Faith-based intelligence

The Senate committee explained this phenomenon in a colder light. It diagnosed a severe case of "group-think": that is, that the spies were failing to test the general assumption that Iraq had a growing WMD programme. To have done so would have been considered heresy; which may be why Hans Blix, the chief UN weapons inspector, accused America of positing "faith-based intelligence."

Thus programmed, America's spies tended to reject any intelligence that didn't support the thesis. Whatever did corroborate it, they embraced, with little regard to the credibility of the source. Accordingly, defectors who claimed that Iraq had abandoned its pursuit of nuclear weapons by the mid-1990s, were dismissed as untrustworthy. Exiled opposition politicians and their relatives—including the dubious Ahmed Chalabi who had not visited Iraq in decades—were considered more reliable. And egged on by men with a keen interest in demonising Saddam, the CIA (and to a lesser degree the British agencies) were compromised at every stage of their intelligence collection and analysis.

When, in 2002, Iraq was found to be importing aluminium tubes that could theoretically be used to make uranium centrifuges, both the CIA and the JIC decided that this was probably the case. Investigators from the International Atomic Energy Agency then pointed out that the tubes could not be used in centrifuges without modification, and that they were in fact being used to make artillery rockets. The CIA dismissed them as naive.

In the face of such conviction, any evasiveness from Iraq—one of the world's most corrupt and incompetent regimes—was taken as an indication of guilt. In particular, where Iraq tried to hide deliveries of dual-purpose material, western spooks always assumed the worst. In fact, Iraqis typically used front companies to evade UN sanctions, and maximise the potential for corruption, on even their most harmless imports.

In response to the report's criticisms, both Mr Bush and Mr Blair reiterated their opinions that the war remained right. They would hardly have said otherwise. But both had argued a case for war based on the threat of Iraq's WMD. Mr Blair persuaded the British parliament to vote for war on the basis of Iraq's weapons—which the prime minister termed a "serious and current" threat—and the connected argument that Saddam had consistently breached United Nations resolutions. Had MI6's intelligence been a little more accurate, he could not have claimed that Britain was under threat.

Mr Bush did not make quite such a specific argument for war. In the slipstream of the outrages on September 11th 2001, he also suggested that Saddam was too bad a man, and too full of hate for America, to be left in power. But, contrary to what some Bushites now claim, the weapons remained the

By the time the Senate judges Mr Bush in the next

cornerstone of his case.

This was why he ordered Mr Tenet hurriedly to prepare the NIE in time for Congress to read before voting on whether to authorise the war. Similarly, when the CIA failed to find a link between al-Qaeda and Saddam Hussein, the administration relied on the threat of WMD to keep fears of such a link alive. Saddam “could decide secretly to provide weapons of mass destruction to terrorists for use against us...it would take just one vial, one canister, one crate to bring a day of horror to our nation,” said the vice-president, Dick Cheney, a few weeks before the invasion of Iraq began.

phase, the verdict will be in from a bigger jury, America's voters. Mr Blair, too, is preparing to face voters next year.

Bruised, not mauled

On the face of it, neither Mr Blair nor Mr Bush was mauled by the inquiries. Lord Butler found no evidence that the prime minister's staff “sexed up” the dossier, though he does show that the intelligence was hardened for public consumption as it went through the system. He blames no individual and does not find any sign that Mr Blair doubted the intelligence he was being fed by the JIC.

In signing off, Lord Butler recommended that greater care be taken to maintain the distinction between intelligence and political persuasion. He also pondered the thought that WMD could still be found in Iraq, a good-sized country, with “lots of sand”.

For Mr Bush's supporters, the Senate report's best sentence was the one that appeared to absolve his administration of the charge that it coerced and co-opted the nation's spies. The Republican-led committee found no evidence that the “mischaracterisation or exaggeration of the intelligence on Iraq's weapons of mass destruction capabilities was the result of political pressure.” But the president is not off the hook yet.

The report is bad news for Mr Bush because it has given Americans yet another reason to regret supporting him over Iraq. The committee's lead Republican and lead Democrat both said that they would not have voted for the war knowing what they know now. However Senator Pat Roberts, the committee's chairman, nuanced this, saying that he would have considered voting for a conflict more “like Bosnia and Kosovo”, which did not involve American ground troops.

Small wonder that an *Economist*/YouGov poll released this week suggests that 61% of Americans believe they were given false information about WMD in Iraq; 70% blame the CIA for misleading them; and 59% blame the White House. Short of the under-the-sand miracle that Lord Butler mooted, Mr Bush's distrust rating seems destined to rise.

For the Senate committee will now embark on the “second phase” of its inquiry, to consider how the administration used the intelligence agencies and their information to make its case for war. It will not complete this task until after Americans have voted in November. But there is already a good deal to suggest that the administration employed strategies to mould the intelligence to its purpose.

Certain statements, by Mr Cheney in particular, tempt the thought that sometimes the administration could not even be bothered with this formality. And Donald Rumsfeld, the secretary of defence, had little use for qualifying evidence when he announced in September 2002 “We know they have WMD. We know they have active programmes. There isn't any debate about it.”

The report contains comments by the CIA's ombudsman, a figure appointed to investigate allegations of political interference in the agency. After interviewing intelligence analysts involved in the drafting of a June 2002 agency paper, which examined possible links between Iraq and al-Qaeda, the ombudsman found that about half a dozen spooks complained of coming under intense pressure from officials. Mostly, this involved being asked the same questions again and again. After conducting a July 2003 investigation into the pre-war intelligence processes, a former deputy chief of the CIA concluded that such “repetitive tasking” was partly aimed at eliciting the desired response.

A more insidious example of the administration's whip-cracking ways was the intelligence-scanning cell established by Douglas Feith, an under-secretary of defence. In mid-2002, Mr Feith detailed two researchers to double-check the CIA's files for links between Iraq and al-Qaeda. Mr Feith has denied that his men had any influence over the gathering or analysis of intelligence. But, in an appendix to the report, John Rockefeller, the committee's vice-chairman, claims that the Pentagon team offered a

hawkish alternative to the CIA's analysis, firmly linking al-Qaeda to Iraq. When Mr Tenet rejected the team's presentation, they took it, says Mr Rockefeller, directly to the White House.

Chasing after fragments

Perhaps most tellingly, Mr Rockefeller accuses the administration of putting pressure on its spies to conform to the certainty contained in its own strident pronouncements. The CIA was faced with the risk of failing to support its government, or of failing to anchor its conclusions in the evidence to hand. In the absence of any substantial intelligence linking Iraq and al-Qaeda, for example, the CIA's agents declined to parrot Mr Bush's characterisation of Saddam in October 2002 as a man “who would like to use al-Qaeda as a forward army.” But the president would not have thanked them for their restraint.

By the time the Senate judges Mr Bush in the next phase, the verdict will be in from a bigger jury, America's voters. Mr Blair, too, is preparing to face voters next year. The Senate report concludes thus: “While analysts cannot dismiss a threat because at first glance it seems unreasonable or it cannot be corroborated by other credible reporting, policymakers have the ultimate responsibility for making decisions based on this same fragmentary, inconclusive reporting.”

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Swing states: Florida

Enter at your peril

Jul 15th 2004 | MIAMI, TALLAHASSEE AND TAMPA
From The Economist print edition

REX

Our series on swing states looks at the biggest prize of all. Once again, everything is not quite as it seems in Florida

MARLOW COOK used to be a Republican senator from Kentucky in the 1960s. Now retired in Sarasota, Florida, the 78-year-old admits: “I know an awful lot of Republicans who tell me they are not going to vote for [George Bush]. I have eight grandchildren and I don't want to see any of them...fight an unnecessary war like the one we just had in Iraq. I think that all of this is going to hurt us in November.” Across the state in Miami, Naife Faillace, a 39-year-old Cuban-American, is blunter: “I'm a registered Republican but I can't support my own party.”

No doubt Ohio is the chief battleground of this year's election. Yet Florida, with 27 electoral-college votes, is worth as much as Ohio and Iowa combined. The opinion polls are tied. More money has been spent there on advertising and voter-registration than in any other state. And, as Mr Cook and Ms Faillace suggest, its old political patterns are changing, making Florida even more unpredictable.

Florida is huge. By road, Pensacola in the north-west is nearer to Indianapolis on the Great Lakes than to Key West. Around 1,000 people move to the state each day. It has a politics of the absurd. Carl Hiaasen's novels describe Florida as a place where people go when they are too mad to live in California (see article).

But you can make some sense of Florida by dividing it into four regions:

• Miami and the south-east form the Democratic heartland (see map). The land of condo canyons and pastel beaches is home to a third of the state's people. Except for Republican-voting Cubans in Miami, the region takes its liberal politics from New York and New England, whose oldsters retire there and bring Democratic politics with them. The I-95 highway runs from Maine to Miami.

• The Republican heartland, the south-western Gulf coast, is smaller: it holds only one in ten Floridians. This is the richest part of the state, a place of gated communities and manicured

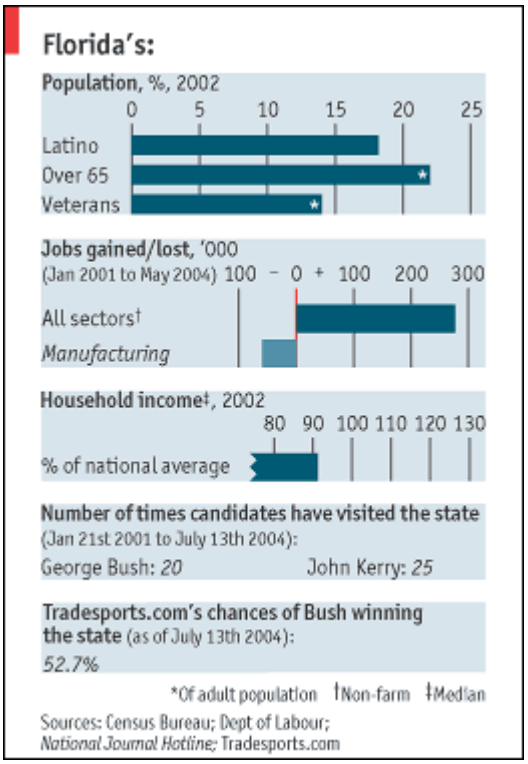
golf courses. Elderly conservatives roll in here from mid-western states like Ohio, Michigan and Illinois.

• The central portion, around the I-4, has grown rapidly to become the core of Florida, with 40% of the population. In the past, the suburbs and rural areas have produced a small Republican majority, though in 2000 the cities of Orlando, St Petersburg and Daytona Beach voted narrowly for Al Gore. As Lance deHaven-Smith of Florida State University points out, these three areas have tended to cancel each other out. Hence the electoral importance of the fourth region:

• The Panhandle. This is the northern bit of the state, from Gainesville upwards, that looks like a gun barrel. Its cast of mind is southern; its nickname used to be LA (which stood for Lower Alabama). In the southern tradition, it usually votes Republican yet remains Democratic by registration. Moderate Democrats can do well here; otherwise Republicans win. The Panhandle used to be the swingiest bit of this swing state.

At least, it seemed that way until 2002, when Bill McBride, a moderate Democrat, won the Panhandle and yet feebly lost the governorship to Jeb Bush. To some Republicans, his defeat showed that the state as a whole is tilting their way. In fact, each bit of the state is getting harder to read, and the I-4 corridor is now the swing region.

Behind the change is the driving force of migration. In the past, it was possible to think of Florida—like, say, Missouri—as a balance of America's regions: north-east, mid-west, South. Now, changing domestic migration and a flood of immigrants are turning it into a melting pot, like New York or California—and swirling up its politics.



Calculations by Bill Frey, of the Brookings Institution, show the extent of the change. From 1950 to 1980, the Panhandle was easily the slowest-growing region in numbers of people. Now it is catching up. Parts of what used to be dismissed as the Redneck Riviera are being concreted over. This year Republican registrations overtook Democratic ones in the north-west for the first time, probably putting the rural part of the Panhandle beyond the reach of even moderate Democrats. Yet the expanding university towns of Tallahassee and Gainesville seem to be turning left.

The Republican south-west, the fastest-growing bit of the state, is changing too. It is not just getting fewer people from the mid-west (the proportion of immigrants coming to Florida from there has dropped from almost 40% in the 1960s to 24% in 2000); it is also getting fewer old people and more young families, not reliably Republican. It would be too much to say that the south-west is becoming competitive. But for the first time Democrats are campaigning busily on the Gulf coast.

The changes also eat into the Democratic south-east. Miami was once the engine of Florida's growth (its population doubled in the 1950s). But the years from 2000 to 2003 saw a net outflow, probably for the first time since Florida became a state. And there are signs that Mr Bush's strong support for Israel may be winning over the Jewish vote in south-east Florida.

But the Democrats are recouping their losses elsewhere. The black population of the south-eastern area rose by 176,000 between 1996 and 2002, largely because affluent blacks are retiring to Miami from the north; most of them are reliable Democrats. And the pro-Republican Cuban lobby is being weakened in two ways. First, as a glance at Miami's restaurants will show, the Cubans are being challenged by a flood of “new Latinos”. The city is now home to 110,000 Colombians and 75,000 Nicaraguans. A quarter of the South American immigrants are university graduates; many are successful business people. Cubans now form less than half the Hispanic vote in this region.

Second, Cubans like Ms Faillace may be getting less reliably Republican. New rules by the Bush administration restricting travel and remittances to Cuba, in order to turn the screw on Fidel Castro, are proving unpopular with younger Cubans. As a result, according to a recent poll, only 66% of Cubans support Mr Bush, compared with 82% in the 2000 election. Whit Ayres, a Republican consultant, thinks the “missing” Cubans will come back to the party on polling day. But for the moment Latinos look like swing voters.

The biggest swing, though, is in the I-4 corridor. Three out of every five Americans moving to Florida now come here. And this makes it even more of a political jumble. The area contains some of the most Republican towns in the state, and some of the most Democratic ones, connected only by that I-4 freeway. More than a third of its immigrants come to work, not to retire. Many of the newcomers are Latinos looking for unskilled jobs in shops and the building and service industries. The I-4 corridor contains 260,000 Puerto Ricans, who lean to the Democrats and have the vote. This increasingly multi-ethnic heart of the state is the most unpredictable battlefield in this battleground state.

Are there any statewide factors that might turn things one way or the other? Governor Jeb Bush remains popular, especially among Latinos (he speaks fluent Spanish). The economy is robust. But Susan MacManus of the University of South Florida thinks the big question is which party can most efficiently get its supporters to the polling station on election day.

Not long ago, the answer seemed to be the Republicans. President Bush's brother has built one of the most formidable party machines in the country, with 60,000 volunteers and captains in every precinct. Yet an extraordinary voter-registration drive by organisations such as America Coming Together and MoveOn.org has narrowed the gap: Democratic voter rolls grew twice as fast as Republican ones during the first four months of this year. Whether the Democrats can get these new voters to the polls remains to be seen. The more established Republican operation has the edge. But it is the narrowest of edges. Both sides have every reason to think they can win.

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And if there is an electoral tie?

Back with Bush and, perhaps, Cheney

Jul 15th 2004 | WASHINGTON, DC
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Trust the constitution to say what happens if it's a dead-heat

ONE senior man at the Bush-Cheney team likes to say that this election could be even closer than the 2000 result, which hinged on those 537 contested votes in Florida. How? There could be a tie in the electoral college.

Remember that America does not have a nationwide vote, but 50 statewide ones. The winner of each state gets all of that state's votes in the electoral college (except in Maine and Nebraska, where votes can be split). The electoral college has 538 votes (the number of seats in the House of Representatives, plus 100 for the Senate plus three for Washington, DC) and it is not all that difficult to see how the two parties could end up with 269 votes apiece.

This could happen, for instance, if all the 17 main “swing states” were to change hands. Or, more simply, if the results of the 2000 race were repeated exactly, except that the Democrats won New Hampshire and West Virginia (in both of which John Kerry is leading).

What then? The constitution covers everything. If nobody has a majority, the president is chosen by the new House of Representatives from the top three vote-getters. But, the 12th amendment adds, “in choosing the president, the votes shall be taken by states, the representation from each state having one vote.” In other words, each state delegation casts one ballot, whether it be California or Rhode Island.

This would make George Bush president. In the current Congress, Republicans are in the majority in 30 state delegations. It would take a landslide to change that, and if there were a landslide there would be no presidential tie.

Meanwhile, says the constitution, the new Senate elects the vice-president. Here things could get distinctly odd. What if the new Senate were also tied, which would be perfectly possible in a close-fought race? In that case, the old vice-president gets to break the tie in his capacity as leader of the old Senate. In other words, Dick Cheney, who is running as the new vice-president, would get to re-elect himself.

Except for one thing: the 12th amendment says that two-thirds of the Senate must be present to form a quorum. So a Democratic boycott could prevent the election of a vice-president.

That might be the least of America's worries. After one election decided by the Supreme Court, followed by another decided by Congress, voters might start demanding a system which gives them the final say. If one could be found.

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Terror on election day

Let the people speak, even so

Jul 15th 2004 | WASHINGTON, DC
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A new 11/2 has to be organised, even after a 9/11

SUPPOSE a terrorist attack hits Philadelphia at noon on November 2nd, causing the city's polling stations to close and would-be voters all over Pennsylvania—and maybe many other states—to stay fearfully at home. The Bush administration, to judge by its terror warnings, does not think this impossible. But when an election official recently asked what would be done about it, Congress reacted in horror. Even to contemplate rearranging the presidential election would be a victory for the terrorists, one lawmaker declared. The White House denied having any such contingency plan.

But is planning for a disrupted election such a bad idea? An electrical failure on the scale of last year's black-out would seriously mess up election day. Al-Qaeda has also shown its vote-stopping power. New York had to suspend a local primary election on September 11th 2001 because of the chaos around Ground Zero; the vote took place two weeks later. Luckily, the local authorities had the power to do this under state law. A presidential election would obviously be far trickier.

Ever since Congress specified a common presidential-election day—the first Tuesday after the first Monday in November—the states have been obliged to go and vote on that day. The constitution would have to be amended to let one state (or a group of them) change the day. And even then there would be problems. Under the 1965 Voting Rights Act, some counties need the Justice Department's approval to suspend an election. This process in theory could take 60 days—longer than the 41 days a state is allowed to choose the electors it must send to the electoral college. Theoretically, state legislatures could appoint these electors, if time runs out. But would that be acceptable to voters?

The problem could be solved if Congress passed a law to address the rare case of a disrupted election. One idea is to name in advance a new date for a nationwide election, should any event derail one or more state elections on the first Tuesday after the first Monday in November. Another is an amendment to the constitution that would allow Congress to reschedule some states' presidential votes, provided enough states, or enough voters in a given state, had been prevented from voting. The Founding Fathers, lucky fellows, had never dreamed of al-Qaeda. Today's America has to face the nightmare.

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The electoral week

On the trail

Jul 15th 2004
From The Economist print edition

The dog-owners vote

"The president of the United States shook hands and nearly kissed a dog."*White House pool report on George Bush's visit to Pottstown, Pennsylvania, where he met a dog named Vixen,* Washington Times*, July 13th*

The rich are different (1)

"Tax cuts for wealthy thugs like me are criminal. I put my tax cut in my sock and buried it away. In November, let's sock it to them."

Paul Newman at a Kerry-Edwards fundraiser in New York. New York Daily News*, July 9th*

The rich are different (2)

"Those very same people never criticised my late husband for his money or his wealth. In fact, they used it...his money was just dandy."

Teresa Heinz Kerry responds to criticisms about her wealth. "60 Minutes", July 11th

Family values

"I'm a native Floridian, I was born in Jacksonville. And I have aunts and uncles all over the state. Don't you embarrass me in front of my family! We've got to win Florida!"

Elizabeth Edwards confronts her personal demons. New York Daily News*, July 9th*

Ah, the irony

"The American president must speak clearly and mean what he says."

Mr Bush, who has never mangled a sentence in his life, lays down the law in Pennsylvania, July 9th

He's back

"All of those that criticised me for my youth and inexperience back in 1988 and are trying to give John Edwards a free pass, they owe me a big-time apology."

Dan Quayle, Scarborough County, MSNBC, July 8th

She's arrived

"She's already given me good advice. She said, 'Dad, change your shirt'."

The president's daughter, Jenna, has been campaigning with him. Washington Post*, July 10th*

Condiment of the week

“You don't support Democrats. Why should your ketchup? W Ketchup is made in America, from ingredients grown in the USA... The leading competitor not only has 57 varieties, but has 57 foreign factories as well. W Ketchup comes in one flavour: American.”

A rival to Heinz. www.wketchup.com

Suffer the little children

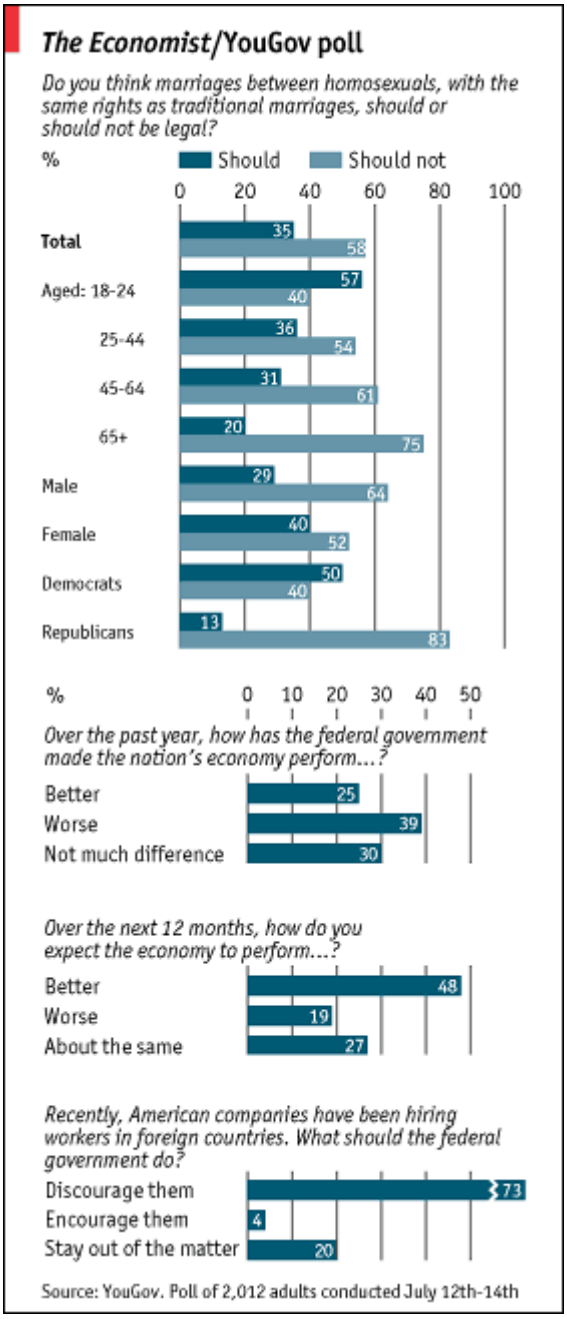
“What really impressed me is that [they] are unbelievable in math. So I've given them a special duty in this election: we're sending Jack and Emma Claire down here to help those Republicans in West Palm Beach count those votes!”

Mr Kerry on Mr Edwards's four- and six-year-old children. Los Angeles Times*, July 9th*

Queer Eye for the Presidential Guy

“Kerry, Edwards are first metrosexual presidential hopefuls”

Front page headline of the New York Sun*, July 13th*



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The Illinois Senate race

Obama heads for the convention

Jul 15th 2004 | CHICAGO
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A "dream candidate" who has also been lucky in his opponents' foibles

THE Clintons wanted their pictures taken with him. His backers include George Soros, Michael Jordan and Christie Hefner. Flattering articles have appeared in places ranging from Washington, DC, to east Africa. Money pours into his campaign. Used copies of his autobiography sell for $50 apiece on the internet. Meet Barack Obama, who looks like being the first black male Democrat in America's Senate.

The Economist first came across Mr Obama last winter in a basement where he was surrounded by law students drinking beer from plastic cups. Now throngs of Chicago's finest queue up to hear him talk about foreign policy, and he is feted at pricey Democratic fund-raising meetings from coast to coast. As if to confirm that he is the next big thing in American politics he has just been asked to give a keynote speech at the Democratic convention.

Mr Obama has certainly been lucky in his opponents. He won the Illinois Democratic primary after a messy divorce destroyed the campaign of the front-runner. Now another marital spat has left him (temporarily) without a Republican opponent in November. Jack Ryan, a good-looking millionaire with a social conscience, dropped out two weeks ago after some racy allegations from his ex-wife. This week the talk was that Illinois's Republicans might choose Mike Ditka, the stocky, cigar-chomping former Chicago Bears football coach and self-styled "ultra-ultra-ultra conservative". Alas for neutrals, Iron Mike ruled out a bid on July 14th, citing worries about his temper.

Mr Obama's rosy prospects are not just the result of his opponents' frailties. He walked over six rivals in the Democratic primary. He was 22 percentage points ahead of Mr Ryan in the last opinion poll taken before the Republican bowed out.

If he is elected, he will be only the third black since Reconstruction to sit in the Senate. He was raised in Hawaii and Indonesia by his white, mid-western mother after his father, a Kenyan economist who came to America on a scholarship, had gone back to Africa without her. He studied international affairs at Columbia and was the first black to edit the *Harvard Law Review*. He has helped to organise black voters in Chicago's poorer districts. A law professor, he is currently also a state senator representing both the richest and the poorest patches of the city.

The result is a candidate who moves between posh liberal suburbs and black city churches with ease. He seems equally at home discussing nuclear non-proliferation or the genocide in Sudan at the Chicago Council on Foreign Relations one day, and then talking about lay-offs or health-care benefits with factory workers the next. It has taken Mr Obama a bit longer to get in touch with rural voters, but political ads filmed for the primary race showing him with Sheila Simon, daughter of the late Senator Paul Simon, a beloved figure in southern Illinois, helped in far-flung corners of the state.

Race is part of Mr Obama's appeal, but it has not always been an advantage. In the months before the Senate primary, there was whispering that he wasn't "black enough" for some blacks. Several years ago he was defeated in a run for a congressional seat by a fiery black incumbent. Although Mr Obama supports affirmative action, he takes a less belligerent approach to racial politics than, say, Carol Mosely Braun, the only black to become a senator from Illinois.

Is Mr Obama saying anything particularly interesting? In foreign policy, he was a relatively early opponent of the war in Iraq. But his domestic message seems less inventive. Despite all those intellectual references, his stump speech is based on much the same optimistic populism as John Edwards's. He also has the same slightly worrying flirtation with protection: he wants to "review"NAFTA to check it includes safeguards for American workers, as well as the environment.

Interestingly, despite his Clintonian veneer and a lot of policy-wonkish talk about high-technology infrastructure and worker-training, the business community portrays Mr Obama as a flaming leftwinger. Back in 1998, the Illinois Chamber of Commerce gave his voting record in the state Senate an 88% approval rating; now he is down to 39% with the business lobby claiming he has supported too many taxes.

Even Mr Obama's most breathless supporters see few signs that he is trying to reinvent his party as Mr Clinton and another academic-turned-pol, Daniel Patrick Moynihan, once did. Maybe the charismatic Mr Obama will realise more of his undoubted potential once he becomes a senator—as seems likely. “The issues don't really matter,” says one party fund-raiser. “This guy is the dream candidate.”

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California in a tangle

The good guy gets tripped up

Jul 15th 2004 | LOS ANGELES
From The Economist print edition

Nothing like politicians to thwart a sensible idea

Get article background

EVEN a megastar cannot dazzle forever, as Governor Arnold Schwarzenegger is belatedly finding. Despite weeks of effort, the governor's negotiating armoury of charm, threats and expensive cigars has failed to give California a $103 billion budget for the financial year that began on July 1st. Not only are recalcitrant Democrats, who control both houses of the legislature, giving the Republican governor a hard time. So are members of his own party. If the deadlock continues to the end of the month, payments to schools and community colleges will have to be cut—with who knows what impact on the governor's main political weapon, his popularity with the voters.

Immediately at issue is a deal Mr Schwarzenegger had worked out with California's cities and counties: they would allow the state to take some $2.6 billion in local revenues over the next two years in return for a constitutional protection against any such raids on their coffers in subsequent years. Unfortunately for the governor, Democratic lawmakers in Sacramento are insisting the state must have the right “in dire fiscal emergency” to raid local coffers as usual—and they say a two-thirds majority in the legislature should be enough to declare such an emergency.

Doubtless some arithmetical compromise can be forged, but the delay means that agreements on other issues may well unravel. Republicans, for example, are unimpressed by a deal struck by Mr Schwarzenegger with California's prison guards, guaranteeing them virtual immunity from lay-offs in return for their agreement to slow pay rises of around 20% due over the next two years. Nor are they impressed by accounting gimmicks such as delaying into the next financial year payments due to some doctors and hospitals.

So what else is new, ask the cynics? In the past 27 years, under Democratic and Republican governors alike, lawmakers have only four times managed to meet the June 15th constitutional deadline for passing a budget. Indeed, the 2003-04 budget was not passed until July 29th, and then only because of all kinds of accounting tricks. The year before that, the budget had to wait until August 31st.

The problem is that Mr Schwarzenegger presented himself to the electorate as someone different. He would balance the books without raising taxes, and break with the past by “cutting up the state's credit card”. If thwarted by selfish lawmakers, he would appeal directly to the people.

But budget minutiae are not easy to put to a direct vote. So the governor, disarmed, has no choice but to haggle with the lawmakers. This means, say his critics, that he is now behaving just as his predecessor did: a concession here, a concession there, some imaginative arithmetic—and put off the day of reckoning. Already his January guess of total state spending has increased in its May revision by around $5 billion, and the “general fund”, the portion of the budget over which the lawmakers have greater discretionary power, has increased by more than $1 billion to $77.6 billion.

Optimists pin their hopes on the recovering economy, which is already boosting the state's tax revenues. But they must be blind not to see the pitfalls ahead too. When the governor pushed the electorate in March to approve another $15 billion in California's bonds, he bought time but not much else. The independent Legislative Analyst's Office reckons that, though the 2004-05 budget may turn out to be more or less balanced, an annual operating deficit of more than $7 billion will emerge the following year. And what then? It is hard to see how Mr Schwarzenegger can avoid raising taxes sooner or later. As one Sacramento insider put it this week: “You put a good guy into a complex situation, and the system's going to win every time.”

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Nuclear waste

Ace in the hole

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A 100,000-year-long debate that could help John Kerry in Nevada

COULD Yucca mountain help the Democrats in November? Most Nevadans loathe the plan for a nuclear dump at the mountain, which has been shoved down their throats by the federal government. Nevada is a swing state, which George Bush won by barely three percentage points in 2000. Meanwhile, John Kerry has long been noisily against the dump.

Once, this looked a bit quixotic. After all, most people outside Nevada thought the matter had been stitched up. The process of preparing the site has been going on for nearly 20 years. Over $5 billion has already been spent on it. And the Bush administration seemed determined to put the dump into operation in 2010. But a surprising court ruling has suddenly thrown a spanner in the works.

At first sight, the judgment on July 9th by a federal appeals court in Washington, DC, seemed to go against Nevada. The judges brushed aside Nevada's assertion that it was unconstitutional to deposit nuclear waste in the state against its wishes. They also said that such decisions are not subject to appeal. This cheered the scheme's backers. Steven Kraft of the Nuclear Electric Institute said it was “a sweeping victory for the project.”

Not so fast, say the scheme's critics. One of the court's rulings does go their way. The Environmental Protection Agency, it turns out, decided to regulate the safety of humans around Yucca for only 10,000 years. That may seem like an eternity, but the waste to be stored there will reach its peak radiation level only after 100,000 years. The National Academy of Sciences, the country's top scientific body, decided some years ago that any safety standard for Yucca should extend to that peak, not a mere 10,000 years. The judges ruled that the EPA erred in not following the NAS guidelines. Either the guidelines get changed, or the Bush administration will have to get Congress to grant the EPA permission to disregard those scientific experts.

This makes life difficult for supporters of the Yucca dump. The federal government can ultimately appeal to the Supreme Court, but it seems unlikely to succeed given that the Washington court's decision was unanimous. Extending the EPA's time-limit looks implausible: “We don't think the EPA can write a regulation for 100,000 years that Yucca can meet,” says one observer.

Some people think that a congressional fix that liberates the EPA from the NAS's advice is the most likely outcome. Perhaps; but that will not happen in an election year. Even after the election, it may be difficult to ram this solution through. Nevada now has some clout in Washington. One of its senators, Harry Reid, is the deputy leader of the Senate's Democrats, and may take over the leadership if Tom Daschle is ejected this November. Last weekend an anti-Yucca pledge was added into the party's election platform. If Mr Kerry is elected, the nuclear-dump bandwagon could at last be derailed.

Bear in mind that one of the first telephone calls John Edwards made on the morning he was unveiled as Mr Kerry's vice-presidential running-mate went to Mr Reid. Mr Edwards had made the mistake of voting in favour of the Yucca dump during his term in the Senate. He was calling to assure Mr Reid that he had changed his mind—no doubt in the hope that this would help a grateful Nevada to vote Democratic in November.

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Lexington

The politics of virtue

Jul 15th 2004
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John Kerry invades territory that the Republicans normally control

Get article background

THE Republicans usually trounce the Democrats when it comes to “values”. Richard Nixon championed the silent majority against the seditious liberal minority. Poppy Bush dismissed Michael Dukakis as a Harvard Yard liberal who believed in letting black rapists roam the streets. In 2000 George Bush neutralised Al Gore's advantages—peace, prosperity and incumbency—by pointing to skulduggery in Washington.

The Republicans' two best cards have always been God and country. Republicans are never happier than when they are battling subversives trying to remove the phrase “under God” from the pledge of allegiance; stopping the varmints from burning the flag or trampling over the Ten Commandments; or just reminding unAmerican sophisticates of the difference between right and wrong, patriotism and treason.

Yet there have been occasions when the Republicans have stumbled over values. In 1992, Pat Buchanan used the Republican convention to announce “a religious war” for “the soul of America”. In 1998, the congressional Republicans tried to impeach Bill Clinton out of office. Now there are signs that it is happening again, not least because the Democrats have been doing a quietly impressive job of invading Republican turf.

John Kerry claims that values will be “the heart of our campaign” (he recently mentioned the V-word eight times in a 36-minute speech). John Edwards waxes lyrical about the values he grew up with in a small town in North Carolina—faith, family, opportunity and responsibility. One of the most ominous current poll figures for Mr Bush is that he trails Mr Kerry by a couple of points on the question, which candidate shares your values?

The most striking turnaround for the Republicans is on patriotism. Suge Knight, the founder of Death Row records, hardly a conservative label, summed up the national mood in the aftermath of September 11th: “We're supporting Bush, we're supporting the USA. At this moment, there's no such thing as ghetto, middle-class or rich. There's only the United States.” The Iraq war has changed this. Most Americans now think the war was a mistake, and many are deeply ashamed of the mistreatment of

prisoners in Abu Ghraib. One of Mr Kerry's new slogans—“Let America be America again”—taps into the idea that America cannot win the war on terrorism if it loses its values in the process.

The Kerry campaign is skilfully using doubts about Iraq to reinforce more general doubts about Mr Bush's personal values, particularly about his honesty. Mr Bush is vulnerable to the charge—never quite stated by Mr Kerry but always in the back of people's minds—that he bullied the intelligence agencies into producing evidence to support his long-cherished plan to invade Iraq. He is also vulnerable to the charge that his administration has frequently played fast and loose with facts (as when the White House claimed in public that the Medicare drugs bill would cost only $400 billion when it knew full well that it would cost much more than that). Mr Kerry is now 13 points ahead on the question of honesty and trustworthiness.

Turning to “family values”, homosexual marriage should have been a slam dunk for Mr Bush—something that revved up the Christian right while reinforcing more widespread doubts about Massachusetts liberalism. This ploy might work at the state level, but at the federal level even senior Bush people admit it is backfiring. This week the Senate Republicans went through the motions of trying to pass a constitutional amendment on marriage, which duly died when six of their number, including John McCain, voted with the Democrats to stop the measure being discussed any further.

Most Americans believe that gay marriage is a step too far, but they are reluctant to stigmatise minorities—and doubly reluctant to change the constitution. The amendment is not even having the galvanising effect on evangelical foot-soldiers that the Republican high command expected. Many regard the constitution as divinely inspired, and prefer the issue to be dealt with at the state level (40 states already have laws against gay marriage).

The Kerry campaign's new emphasis on values is aimed at two groups of voters. The first is what pollsters call “secular-values voters”: people concerned with questions such as corporate ethics and America's image in the world. Mr Bush looks vulnerable among these voters on several scores. The second is non-evangelical Christians in rural and small-town America. Mr Edwards will spend much of his time charming them with tales of his small-town upbringing.

The values deficit

More generally—and more ambitiously—Mr Kerry wants to raise the same question about a “values deficit” in the Bush White House that Mr Bush did about the Clinton White House. Enron, Halliburton and Abu Ghraib could become Mr Bush's Monica Lewinsky. There will be countless pictures of Mr Kerry in Vietnam, the grunt in uniform, to compare with those cowardly war-mongering neo-conservatives around Mr Bush.

Of course, Mr Kerry may over-reach himself. How on earth can he claim to represent true conservative values (as he implied he did last week) when he hangs out with Hollywood stars like Whoopi Goldberg, who make cheap jokes about Mr Bush's name? How can a veteran senator claim to be an outsider? And how can he pose as a champion of ordinary people when his wife is worth $1 billion? A White House insider jokes that the Democratic ticket is a perfect example of Mr Edwards's two Americas: billionaires and millionaires. Already Laura Bush, the librarian, is being wheeled out for voters to compare her with the more exotic and eccentric Teresa Kerry.

In short, Mr Bush will defend his home turf fiercely. Yet it is noticeable that, this time, the Democrats are trying to grab it. And so far at least they have not done at all badly.

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Bolivia's referendum

Counter-reform—or muddle along?

Jul 15th 2004 | LA PAZ
From The Economist print edition

AP

The survival of Bolivia's government—and of foreign investment in the country—turns on approval of an oil and gas referendum

Get article background

LAST October, a popular uprising led by radical leftist groups ousted Bolivia's president, Gonzalo Sánchez de Lozada, at a cost of 59 dead. The vice-president, Carlos Mesa, took over the top job, and is trying to steer a disgruntled country riven by ethnic tension until the next election in 2007. On July 18th, he faces a crucial test. In a referendum, Bolivians will be asked what they want to do with their oil and gas wealth—the issue that served as a catalyst for protest last October.

Bolivia is the poorest country in South America. But thanks to foreign investment in exploration, it now has the continent's second-largest gas reserves outside Venezuela. Bolivia also has a habit of setting political trends. So the referendum may be seen as a sign as to whether—or at least on what terms—energy multinationals have a future in South America.

The radicals who led last October's protests want to renationalise the oil and gas industry, largely privatised by Mr Sánchez de Lozada in an earlier term in the mid-1990s. Mr Mesa is trying both to appease social protest and salvage the possibility of future private investment in energy. It is a difficult balancing act. One sign of that is the referendum's convoluted questions (see table). These seem judiciously crafted to ensure approval.

The first three questions represent a partial retreat from the free-market policies espoused by Bolivia since the mid-1980s. These delivered steady economic growth—but not enough to dent poverty. Contrary to appearances, the last two questions are an attempt to gain popular backing for gas exports. These are crucial to Bolivia's economic prospects. But the issue has become entangled with another one: the country's continuing hurt at the loss of its coastline to Chile in an 1879-83 war. That killed a scheme backed by Mr Sánchez de Lozada (known to

Bolivians as “Goni”) to export gas to California via Chile.

Bolivians have almost no previous experience of referendums. Officials hope that they have turned the vote into one on whether to back or sack their president. Mr Mesa, a historian of little political experience, is popular, but lacks a dependable majority in Congress; he has shunned most of Bolivia's discredited political parties. “If there is a No vote Carlos Mesa will go. If he gets a Yes he will gain an enormous level of legitimacy,” says Ramiro Molina, a historian at La Paz's University of the Cordillera.

Opponents on the right have denounced the referendum questions as “tricks”. Naming Goni, who is now deeply unpopular, in the first question ensures its approval. The radicals wanted a question on renationalising the industry—something Mr Mesa has ruled out. Evo Morales, the leader of the coca workers and the runner-up in the 2002 election, has given equivocal support to the government, but wants a No vote on the last two questions.

The leftists first called for voters to write “nationalisation” across the ballot. They have since threatened to disrupt the vote by blocking roads and burning ballot boxes. Though disorder is possible, the signs are that Mr Mesa will get his referendum victory. Only a simple majority of votes cast is required for approval, so boycotts would not help opponents.

Bolivia is not for beginners

The referendum questions:

1) *Do you agree that the Hydrocarbons Law (No 1689) approved by Gonzalo Sánchez de Lozada should be repealed?*

2) *Do you agree that the state should recover ownership over all hydrocarbons at the wellhead?*

3) *Do you agree that* YPFB *(the state-oil company) should be re-founded, recovering the state's ownership of stakes held in the part-privatised oil companies, so that it can take part in all stages of the hydrocarbon production chain?*

4) *Do you agree with President Carlos Mesa's policy of using gas as a strategic resource to recover sovereign and viable access to the sea?*

5) *Do you agree that Bolivia should export gas under a national policy framework that ensures supplies for Bolivians; encourages the industrialisation of gas on national territory; levies taxes and/or royalties on oil companies up to 50% of the production value of oil and gas; and earmarks resources from the export and industrialisation of gas mainly for education, health, roads and jobs?*

Sources: National Electoral Court; *The Economist*

So far, Mr Mesa has been a fireman, though a fairly effective one. Street protests have continued, but with declining force. If the referendum gives him a new mandate, he will have a chance to settle the energy issue. Initially, he wanted to approve a new hydrocarbons law before the referendum. Now a new law is to follow the popular vote. It is certain to include an increase in taxes on multinationals with fields in Bolivia, who include Spain's Repsol-YPF, Brazil's Petrobras and Britain's BP and BG Group. The industry has invested some $3.5 billion since 1997. Oil and gas producers say that the government already takes 69% of their pre-tax profits; in 2003 these totalled $122m on revenues of $806m. The government also wants to increase its say over the destination and price of exports of oil and gas. And it wants to revive the state oil company, giving it a stake in all future projects.

When the existing hydrocarbons law was approved in 1996, “the priority was finding reserves,” says Carlos Alberto López, a former energy minister and now a lobbyist for the industry. “Now, its opening markets.” He claims that the multinationals accept that the law needs revising. But they are opposed to unilateral changes in contracts for existing fields. “The government has allowed the misconception to grow that a yes vote will mean an automatic change to our contracts and this is not the case,” says Mr López.

If the referendum is defeated and Mr Mesa falls, renationalisation of the industry might follow. Approval would be a less bad outcome. But already, uncertainty has caused foreign investment in Bolivia to plunge. Next door in Argentina, President Néstor Kirchner says he will set up a new state oil company. In Venezuela, Hugo Chávez relies on multinationals to produce a rising share of his country's oil. But with Mr Kirchner, he is setting up Petrosur, a regional state-owned enterprise aimed at strengthening government control over oil. It is hardly surprising that, Brazil and Trinidad apart, the continent barely figured in a worldwide survey of new oil developments published this week by Reuters. Oil and gas may be a problem, but having none is a bigger one.

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Colombia's anti-guerrilla war

Victories, but no Waterloo

Jul 15th 2004 | BOGOTÁ
From The Economist print edition

Turning the tide against FARC

Get article background

IT IS the largest offensive by the Colombian army since troops descended on peasant militias who had set up a self-styled Independent Republic of Marquetalia in 1964. The scattered survivors of that push formed the Revolutionary Armed Forces of Colombia (FARC), Latin America's oldest and largest guerrilla army. Over the past two decades drug money, extortion and kidnapping have allowed the once Marxist FARC to expand to a peak of some 17,000 fighters in 2002. Now, Colombia's president, Álvaro Uribe, is trying to knock the organisation out. In a series of operations dubbed the "Patriot Plan" he has launched 15,000 troops and special forces, backed by American-supplied helicopters, against the guerrillas' strongholds in the country's southern jungles.

The plan's first phase, begun a year ago, sought to clear FARC from the mountains around the capital, Bogotá. Five local guerrilla commanders were killed, and four more captured. FARC kidnappings and its planned "siege" of Bogotá were disrupted. The number of guerrilla fighters ringing the capital was cut by two-thirds, to fewer than 400. The capital's better-off residents are now able to travel to weekend retreats with less fear of being abducted.

The current phase of the Patriot Plan, begun at the end of last year, takes the fight to areas such as Caquetá and Guaviare, much of which have been held by FARC for decades. Its aims include recapturing territory, disrupting the guerrillas' logistical and training bases, and trying to capture or kill their top leaders.

So far its results have been mixed. In all, between January and May the army claims to have killed 851 guerrillas (some from the smaller National Liberation Army, known as the ELN), or 15% more than in the same period last year. It also says that in this period 724 deserted, up from 521 last year. Earlier this month, the army destroyed a huge ammunition dump at a camp allegedly used by Jorge Briceño (aka Mono Jojoy), the rebels' military commander. The army has built outposts in FARC territory, such as at Miraflores, where clandestine airstrips and money-exchange houses are testimony to the drug trade. But the operation has netted only one commander: "Sonia", who was responsible for managing drug income.

Officials play down hopes of a spectacular victory. "The country cannot expect a big battle, a Waterloo," says Jorge Uribe, the defence minister (a relation of the president). He describes the Patriot Plan as "a jigsaw puzzle" of simultaneous small operations. He refuses to set a time limit for success. It could take up to four years. But "the tide has turned and there is an end in sight," he says. General James Hill, who heads the United States' Southern Command, said after a recent visit that he hoped FARC would be rendered "combat ineffective" by 2006.

The government hopes that sooner or later its offensive will force FARC to the negotiating table. Colombia's other two illegal armies, the ELN and the right-wing paramilitary vigilantes of the United Self-Defence Forces of Colombia (AUC), both say they are interested in peace talks; indeed, some of the AUC's leaders have gathered in a "location zone" in northern Colombia to talk peace. The talks face many obstacles. But the government's strategy is more or less clear.

Can the Patriot Plan succeed? Alfredo Rangel, a defence analyst, believes that the lumbering push into Caquetá has deprived the army of surprise, meaning that it is unlikely to capture any of FARC's jungle-hardened leadership. He reckons the guerrillas' strategy is to avoid battle. A further doubt concerns the possible dwindling of American support after 2005, when the aid programme known as Plan Colombia officially ends.

There are signs that FARC is feeling the pressure. In what may be an effort to boost its dwindling drug income, it has resorted to massacring peasants in coca-growing areas—a tactic more often associated with its paramilitary foes. Whether or not the Patriot Plan knocks out FARC, it has certainly put it on the defensive.

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Mexico's first lady

Marta bows out

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The president will not, after all, be succeeded by his wife

Get article background

THIS time, it seems, the dream really is over. On July 12th, Marta Sahagún read a terse statement announcing that she would not seek to succeed her husband, Vicente Fox, as Mexico's president, in an election in 2006. Thus ended an avalanche of speculation and intrigue that had all but buried Mr Fox's presidency over the past year. As often as he would rule out his wife's political ambitions, she would seem to publicly contradict him.

Two things forced Marta (not Martha, as we mistakenly called her last week) to pull out. The first was a decision by her husband's conservative National Action Party (PAN) to choose its presidential candidate by a ballot of party militants rather than an open primary. Ms Sahagún is mistrusted as a political parvenu by many *Panistas*. Her only option would have been to risk humiliation by standing for one of several fringe rent-a-parties.

The final blow was the stinging resignation letter tendered on July 5th by Alfonso Durazo, Mr Fox's private secretary. In it, he spelt out just how far Ms Sahagún's political ambitions were destabilising the presidency. And he warned that Mexico's fledgling democracy would be jeopardised if it was perceived that Mr Fox was working “to leave the presidency to his wife”.

Even loyalists had been dismayed by allegations against Marta's charitable foundation, *Vamos México*. Critics always saw this as a vehicle for her own Catholic social agenda and for raising her profile, rather than to help the poor, its professed aim. Recently, it has been accused of spending too much on administration, and improperly receiving public money.

Despite all this, Ms Sahagún remains popular, especially with women. She has often said that her true opponent is Mexico's reactionary, macho culture. She is also the victim of snobbery for her provincial origins. She may fail to become Mexico's Eva Perón, let alone Hillary Clinton. But she might still seek minor office, in Congress or as a state governor. It may be a case of *hasta luego* rather than *adiós*.

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Peruvian cuisine

A guinea pig for all tastes and seasons

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From The Economist print edition

The birth of the mega cuy

THE first thing Fernando Escobal hears when he steps out of his small office at the National Agrarian Research Institute in Cajamarca in Peru's northern Andes is a chorus of chirps. The sound comes from thousands of guinea pigs held in mesh cages. They are destined not for pet shops but for the table. Mr Escobal hopes they will improve the diet of many of the poorest Peruvians.

The guinea pig, or *cuy* as it is known in Peru (from its chirping cries), is a delicacy throughout the central Andes. It was domesticated nearly 5,000 years ago. “Raise guinea pigs and eat well,” enjoined an Inca saying. Spanish colonial paintings of the Last Supper in the cathedral in Cusco, the former Inca capital, and in Lima's San Francisco monastery portray Christ and his apostles feasting on a plate of roasted *cuy*. The rodent is still a fixture on Andean feast days. It is also used by traditional healers to diagnose illnesses. The animal is passed over a sick person, and then split open and examined for clues to the disease.

Peruvians already get through 22m guinea pigs a year. Mr Escobal and his team hope to persuade them that *cuyes* should not be kept for special occasions, but eaten far more regularly. To that end, they have developed some new breeds. On July 16th, they launched a new super-*cuy*, known as Peru, weighing up to three kilos (seven pounds).

According to the agriculture ministry, guinea-pig meat has more protein and less fat than chicken or pork, let alone red meats. Now, one *cuy* will easily feed a family of four. The new breed may also interest the discerning gourmet. *Cuy* tastes rather like rabbit. In Cajamarca, it is stewed; further south, it is split open, flattened and fried a crispy brown. The institute has drawn up a long list of other recipes. The main drawback of guinea pig is that it has rather a lot of small bones for not much flesh. Science may at last have changed that.

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Canada

Look, no debt

Jul 15th 2004 | TORONTO
From The Economist print edition

Oil and a Conservative success

THE blue-eyed sheikhs of Alberta used the colourful backdrop of this month's Calgary Stampede to remind the world that OPEC is not the only winner from high oil prices. At one rodeo event, a rushing bull triggered the closing bell of the stock exchange in faraway New York, as Calgary tourism officials handed out cowboy hats on the trading floor. A few days later, Ralph Klein, Alberta's premier, took time off from flipping pancakes at a Stampede breakfast to announce that his government would wipe out the last of the province's remaining debt.

Alberta produces most of Canada's oil and natural gas. As energy prices have climbed, so have royalties: from an annual average of C$3.2 billion ($2.3 billion) between 1993 and 1999, they have since soared to C$7 billion a year, according to Derek Burleton, an economist at Toronto-Dominion Bank. The result: Alberta is the richest of Canada's ten provinces, and the only one without a provincial sales tax. Its economy should grow by almost 4% this year, well above the national average. That figure would be even higher had Alberta's other mainstay, cattle ranching, not been hit by a case of mad-cow disease in 2003. Shipments of most cuts of beef have resumed, but exports of live cattle to the United States are still banned.

Mr Klein's announcement of a debt-free province seems to presage an autumn provincial election. A former television reporter, Alberta's premier is one of Canada's more colourful politicians. When he was mayor of Calgary in the 1980s, he blamed “eastern bums and scums” for straining the city's social services. After a shouting match with a homeless man in Edmonton, he acknowledged that he had a drinking problem. Last year, he was taped at a private meeting saying that the farmer in the mad-cow case should have “shot, shovelled and shut up.”

But the plain-speaking Mr Klein is also an astute politician. Since becoming premier 12 years ago, he has changed the way Albertans view their government, says Peter McCormick, a political scientist at the University of Lethbridge in the province. Mr Klein's Progressive Conservatives have led Canada in deregulation and privatisation. Car licensing, liquor retailing and electricity distribution are among the services now in private hands.

Shortly after taking office, Mr Klein pushed through a law mandating a balanced budget and requiring that three-quarters of any budget surplus be used to pay off debt. The Conservatives initially balanced the books by selling assets and chopping health and education spending. As anyone caught in a Calgary traffic jam will attest, cities were starved of funds for infrastructure. Teachers are among the premier's fiercest critics. Deregulation has failed to bring down electricity charges, as Mr Klein had promised. “Some of it has been done clumsily,” says Mr McCormick.

Oil and gas have come to the rescue. Discretionary spending has jumped by 42% over the past five years. Besides paying off almost C$23 billion in debt, Mr Klein has set up a “sustainability fund” to cushion the province when energy prices fall. Even so, if that happens, the government will doubtless borrow again.

The Conservatives are all but certain to win the coming election. But Canada's longest-serving premier has begun to show signs of both hubris and boredom. On the national stage, he is a fading force. Now that his province is debt-free, Mr Klein may decide that flipping pancakes is much more fun than trying to find a fresh challenge for his government.

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Japan

What goes up must come down

Jul 15th 2004 | TOKYO
From The Economist print edition

EPA

Voters send Junichiro Koizumi a deflating message

Get article background

HIS coalition went into the election with a lock on power, and did not lose any seats. Yet the outcome of Japan's upper-house election on July 11th embarrassed Junichiro Koizumi. The prime minister's Liberal Democratic Party (LDP) won 49 seats: two short of its minimum election target and, more embarrassing, one seat less than the main opposition party, the Democratic Party of Japan (DPJ).

The LDP's weak result followed a sharp slide in Mr Koizumi's popularity in recent weeks. He rushed a scandal-tainted pension bill through parliament, and then agreed, without any debate, to affiliate Japan's troops in Iraq with a new multinational force. These decisions reinforced a growing public sense that Mr Koizumi—whose reputation as a tough-talking maverick made him wildly popular three years ago—has grown arrogant and out of touch.

Despite the setback, Mr Koizumi said this week that he will not step down. The LDP and its coalition partner, the Buddhist-backed New Komeito, already control the lower house, which picks the prime minister. And because elections for the upper house replace only half of its MPs every three years, the coalition still retains 139 of that chamber's 242 seats, giving it not only a solid majority but the right to go on controlling all of its committees. The upper house's powers are limited, anyway.

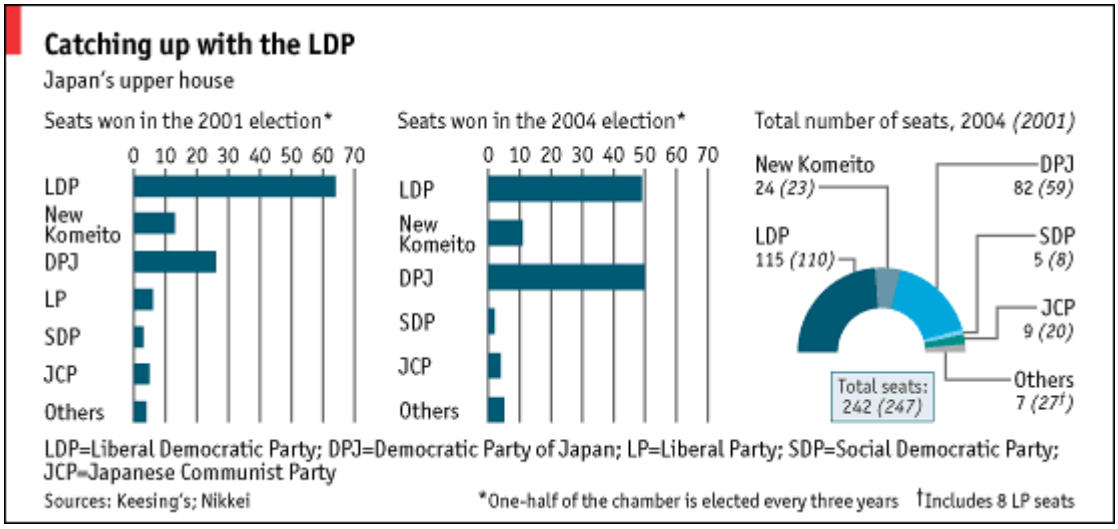
Mr Koizumi says that, as previously planned, he will shuffle his cabinet this September and then stay on as prime minister until September 2006, when LDP rules dictate that his term as the party's leader must come to an end. But even if he can hold on to his job until then, can he accomplish much after this week's unimpressive showing at the polls?

The prime minister has not played the game the way that his predecessors did, building their power firmly upon the LDP's factional politics. Instead, he has relied on his personal popularity to keep detractors within his own party in line. True, his ruling coalition retained its existing number of seats in this week's election. But the results show plainly that Mr Koizumi is not nearly as popular as he was after sweeping into office in April 2001.

That summer, he led the LDP in an impressive upper-house campaign, picking up 64 of the 121 seats being contested and helping New Komeito to win a further 13 seats. This time, by contrast, the coalition

was able to hold its ground—the LDP lost a seat, New Komeito gained one—only because it was competing for seats that had last been contested in 1998, when the LDP put in a dismal showing that forced the prime minister at the time, Ryutaro Hashimoto, to resign.

Mr Koizumi did somewhat better than Mr Hashimoto did in 1998. The LDP won 30% of the vote for proportionally-elected seats (compared with 25% in 1998) and 35% in the district contests (up from 31%). But that victory is outweighed by the fact that Mr Koizumi did poorly when compared with his former self. Opinion polls show that, at around 40%, his popularity is half what it once was.



The oddities of Japan's party system make it hard to predict what this means. The country is making a transition from one-party rule, with the LDP in charge almost continuously since 1955, to a genuine two-party democracy. After merging with the opposition Liberals last year, the DPJ made impressive gains in November's lower-house election, at the expense of the Communists and the Social Democrats. This week's election reinforced that trend. The two left-wing parties were defending 17 seats in the election, but won only six. The DPJ now has 82 seats in the upper house, up from just 59 after the last upper-house election. On its third leader in as many years, the DPJ, with the relatively youthful Katsuya Okada (a mere 51) at its helm, has clearly emerged as the dominant opposition party, with a chance of governing the country one day. But in this week's election, it had no chance of winning, which made the vote more of a referendum than anything else.

In the shorter term at least, this suggests that the election could well result in politics becoming less partisan, not more. Mr Koizumi's real enemies remain the conservatives within his own party, not the formal opposition. By co-operating more with the Democrats—on pension reform, for instance—and standing firm against his own party, he still has a good chance of shoring up his popularity and keeping his LDP opponents at bay.

This is partly a matter of policy. On issues such as decentralisation, bank reform and competition, Mr Koizumi's reformist language is much closer to the Democrats' policies than those of his LDP detractors. Most floating voters do not oppose Mr Koizumi's reform ideas so much as his failure to carry them out. And as a matter of presentation, co-operating more with the Democrats could allow the prime minister to escape from a trap: on the one hand, voters see him as arrogant, but on the other they threaten to turn against him if he makes too many concessions to opponents within his own party.

When he shuffles his cabinet in September, Mr Koizumi would therefore be wise to show voters that he is not caving in to the LDP's old-guard, much of which he has already infuriated by breaking with tradition on cabinet appointments, choosing people he can work with rather than those who are next in line on the party escalator. He has also shuffled the cabinet far less often than the LDP used to do. Nonetheless, the LDP still contains plenty of old-fashioned anti-reformist politicians.

If Mr Koizumi is able to name a new team more to his and the public's liking, and at the same time demonstrates that he can compromise with the Democrats on issues that voters care about, he could still do a lot to restore his popularity. An uncompromising attitude is not deemed “arrogant” if the public agrees with you. A skilled tactician like Mr Koizumi should have little trouble grasping that.

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America, China and Taiwan

Dangerous games

Jul 15th 2004
From The Economist print edition

The turbulence ahead

Get article background

EVERY summer for the past ten years, China has pointedly rehearsed military drills or missile tests, or both, ready for a possible invasion of Taiwan. Unusually, this month's war games were given advance billing, and their aim was spelled out publicly: to warn Taiwan "separatists" and other "outside forces" that China will not tolerate any effort to split the island away. A similar message was delivered in private last week to the visiting Condoleezza Rice, President George Bush's national security adviser: China would not sit idly by, said its former president, Jiang Zemin, should Taiwan's leaders continue their drive for independence. China has said this, and more, before. But there is reason to think that America, China and Taiwan may be in for more turbulent times.

One is Taiwan's outspokenly independence-minded president, Chen Shui-bian. Earlier this year he was re-elected with an increased share of the vote (albeit by only the slimmest of margins). Four years ago, China's heavy-fisted threats bolstered his support. This time, China backed off, but the result was no more to its liking. It will find Mr Chen an even more awkward customer if his Democratic Progressive Party wins enough seats to control parliament later this year.

Mr Chen also annoyed President Bush earlier this year, by holding a referendum to coincide with his re-election bid, highlighting the threat to Taiwan from the 500 or so missiles China has pointed at the island. Although Mr Bush has been a strong supporter of Taiwan—agreeing to sell it advanced weaponry for its defence, and loosening tight restrictions on visiting politicians, including Mr Chen—he has also called on Taiwan not to take any actions unilaterally to change the status quo and so risk a conflict in the Taiwan Strait. America already has its hands full with the post-September 11th war on terrorism, and with the struggle to stabilise Iraq. It also needs China's help to rein in the nuclear ambitions of North Korea. But is Mr Chen listening?

China fears he may yet propose a referendum on independence for Taiwan. At that point, says China, force cannot be ruled out. Meanwhile, a new constitution for Taiwan's vibrant new democracy is due to be drafted by 2006, and adopted by referendum in 2008—the year that Beijing hosts the Olympic games. Might Mr Chen miscalculate that China's leaders would be too concerned about a boycott in the run-up to the games to try thwart an independence bid?

Despite the furore back in 2001 when the Bush administration agreed to help Taiwan buy more advanced aircraft, ships and submarines, Mr Chen's government has yet to make the purchases. He seems to take it for granted that, if he offends China too far, America will always rush to his rescue. But according to a new report, "Deterring Conflict in the Taiwan Strait" by Michael Swaine of the Carnegie Endowment for International Peace, America's defence planners are increasingly concerned that, while Taiwan drags its feet on military modernisation and Mr Chen plays his political games, China is rapidly acquiring the means to launch a rapid "decapitation" strike at Taiwan, before America would even have time to respond.

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India

Closing the gap

Jul 15th 2004 | DELHI
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Big reforms are planned for next year's budget; but will they survive?

AP

Chidambaram, the man with the plan

IF PALANIAPPAN CHIDAMBARAM, a successful international corporate lawyer, had not been made finance minister in India's new Congress-led coalition government in May, he would have been in London this week, working on one of his many international arbitration cases. Instead, he is in Delhi, starting work on reforms for his full annual budget, due at the end of next February. He is also coping with attacks on his disappointing interim budget, announced on July 8th.

The attacks have mainly come from stockmarket traders, who object to a new tax on transactions, and from leftist parties in the coalition government, which oppose plans to raise foreign direct investment ceilings in insurance, telecoms and aviation. Mr Chidambaram plans to placate the traders by adjusting the tax. But he may have problems acquiring the necessary parliamentary approval for the insurance proposal. The opposition Bharatiya Janata Party—though it authorised foreign investment in the insurance sector in 1999—says it will oppose it.

Reforms in the next budget in February will focus on taxation, subsidies and development expenditures. This week, Vijay Kelkar, an adviser to the finance ministry, is expected to submit tax proposals updating his first report, produced at the end of 2002, which encountered stiff resistance because it suggested abolishing thousands of exemptions. Mr Kelkar's five-year plan seeks to eliminate the government's revenue deficit (amounting to 3.5% of GDP) by integrating goods and services taxes, reducing tax rates but spreading the tax net broader. He has also proposed experiments in public-private partnerships in areas ranging from roads to school meals.

By the end of September, Mr Chidambaram should also receive a report recommending the reduction over five years of India's ubiquitous subsidies, on power, water and a great deal else. These amount to about 11% of the country's GDP. But the parties on the left of the coalition can be expected to resist attempts to touch these handouts. The cuts tie in to a plan to refocus the 1,410 billion rupees ($31 billion) annual planned development expenditure. The government wants both to reduce the amount that ends up in the hands of the well-off and to end the theft of such funds by civil servants, contractors and others. Mr Chidambaram reckons that up to 40% of the cash is probably lost this way, though the figure could be as high as 75% in the most backward states, and some analysts put it even higher.

Ideally, the government would like to devolve responsibility for allocating and managing funds to districts and village councils. But this is a revolutionary idea, and will be resisted by politicians and officials in the central and state governments, who enjoy the power of patronage they derive from the present system.

Montek Singh Ahluwalia, a former finance secretary brought back last month from the IMF to run the Planning Commission, is in charge of this exercise. He says that India's “high noise to signal ratio” can make opposition sound more entrenched than it is. As part of a reformist threesome—along with Manmohan Singh, the prime minister, and Mr Chidambaram—Mr Ahluwalia now has a chance to test his theory. The test had better work. India's hope of better government and wider prosperity now depends on the reforming threesome.

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The Philippines

A dangerous gamble

Jul 15th 2004 | MANILA
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The attempt to save a hostage in Iraq could backfire

AP

Their voices were heard

IN TRYING to save the life of a Filipino civilian taken hostage by Iraqi terrorists, the government has risked doing further damage to its already shaky reputation as an ally in the American-led war on terrorism. By apparently giving in to the hostage-takers' demand for an early withdrawal of Filipino troops and police from Iraq, it is also contradicting its tough stand against its own domestic terrorists.

On July 7th, Iraqi insurgents announced they had abducted a Filipino truck driver, Angelo de la Cruz, and threatened to behead him unless the Philippines withdrew its token contribution to the multinational force in Iraq by July 20th. The Philippines has sent about 50 soldiers and policemen to Iraq on what it calls a humanitarian mission, involving non-combat tasks such as building classrooms and clinics, and training Iraqi police officers. This was a gesture of gratitude for American help in dealing with Muslim terrorists in the Philippines, who also make a habit of kidnapping foreigners and threatening to behead them. The mission was due to end on August 20th, although the government had said it was prepared to maintain a military presence in Iraq after that date, if under the auspices of the UN.

Following attempted negotiations with Mr de la Cruz's abductors, Filipino authorities announced this week that, in response to their demand, its contingent would be withdrawn as soon as possible. No date was set for the withdrawal, although the government later implied that it had already begun. The American and Iraqi governments strongly disapproved, having expected the Philippines to follow its traditional policy of not giving in to terrorist threats. The government appeared to be trying to satisfy both the kidnappers—by telling them they would get what they wanted—and its allies—by quietly reassuring them that it would, in fact, maintain its force in Iraq until its mission ended.

President Gloria Arroyo has found herself under growing domestic pressure to save Mr de la Cruz. There is great public sympathy for the 46-year-old, a father of eight children. In addition, countless Filipinos are supported by the remittances sent home by their 7m or so compatriots who work overseas, including some 4,000 who are in Iraq.

But Mrs Arroyo's apparent tactic in trying to save Mr de la Cruz has dangerous potential consequences. If the kidnappers suspect the Philippines of deceit, other Filipinos in Iraq and possibly elsewhere might be put at risk. And the United States is unlikely to be impressed by the notion that the Philippines was only pretending to give in to the kidnappers. On the other hand, if Mr de la Cruz's abductors believe, even incorrectly, that they have succeeded in forcing the Philippines' hand, the citizens of all the other countries that have contributed troops to the multinational force in Iraq are even more at risk.

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Uzbekistan

An embarrassing friend

Jul 15th 2004
From The Economist print edition

The United States is suspending aid to the government of Uzbekistan

Get article background

THIS has been a painful year for Uzbekistan's government. In April, the European Bank for Reconstruction and Development suspended most of its assistance to the Central Asian government due to its dismal record on economic and political reform, as well as human rights. Now America—Uzbekistan's best foreign friend—is doing the same. On July 13th, citing lack of progress on democratic reform, the State Department announced that Uzbekistan's government had not passed the test for assistance this year.

The autocratic regime is a useful American ally in the region and has been repeatedly praised in Washington for its anti-terrorist efforts. Following the terrorist attacks of September 2001, Uzbekistan allowed America to build an air-base on its soil, which helped the military operation in Afghanistan. In 2002, the two new friends signed a Strategic Partnership Framework, and Uzbekistan received $220m in cash.

But despite its strategic position and enthusiasm for crushing radical Islamists, Uzbekistan is also an embarrassing friend. It is amongst the least reformed of the former Soviet states. No opposition party has been allowed to register. There has been little movement towards market reform, and moves towards currency convertibility last year have been undermined by severe trade and financial restrictions. Pious Muslims are caught in the hunt for terrorists. There are thousands of religious and political prisoners, and torture is routine. Continued foreign assistance has fed criticism that human rights were taking a back seat to the war on terror.

American officials have countered criticism by pointing to the diplomatic pressure they were putting on the Uzbekistani authorities. But they have little to show for it. So assistance to both government and NGOs shrank to $86m last year and $55m this year. In January, America declared Uzbekistan ineligible for assistance for non-proliferation efforts, although it used a national-security waiver to keep the money flowing. No such waiver is available this time, and military assistance as well as money meant for economic reform—the main components of the aid package to the government—are to be cut or redirected through NGOs.

The move has been welcomed by human-rights organisations. Its significance, however, is much more symbolic than practical. The amount earmarked for the government was only $18m.

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About sponsorship

China

Engulfed by pyramids

Jul 15th 2004 | FUAN
From The Economist print edition

A co-operative credit scheme goes badly wrong

Get article background

AT LEAST three lavishly furnished villas owned by some of the wealthiest residents of Fuan, a city in Fujian province near the southern Chinese coast, have been gutted by angry mobs. In an orgy of vengeance in late May, hundreds of citizens looted everything inside. They smashed all the windows, ripped out stair boards, air-conditioners, western-style lavatories and electrical sockets, and hauled off the metal gates.

The owners of these and several other villas have either fled or are in jail. They are among scores of Fuan citizens accused of defrauding investors in an informal network of credit associations of tens of millions of dollars. These unregistered groups had grown in recent years to become the city's most popular financial institutions, sucking in far more money than the state-owned commercial banks.

The associations had metamorphosed from small, close-knit groups into huge, risky structures linked to Fuan's underground gambling businesses and operated effectively as pyramid schemes. Their collapse in May was a colossal financial blow to many households in Fuan, which, together with its surrounding towns and villages, has a population of some 600,000.

Credit associations known as *biaohui* have a centuries-old history in parts of eastern China, and helped fuel the growth of many enterprises across the strait in Taiwan. Unlike China's state-owned banks, which have rigidly managed interest rates and tend to shun small private businesses or individuals in need of funds, *biaohui* can offer credit when it's wanted, and for investors the possibility of a higher rate of return than bank deposits.

In Suti, a village nestling at the foot of verdant hills an hour's drive from the main urban centre, residents say many in the ancient community of several thousand people are now deep in debt. Pushing handfuls of dry tea leaves around a large tray to illustrate their points, they explain how their *biaohui* grew to encompass virtually every village household, drew in rich speculators from the city and then spectacularly imploded along with the rest of Fuan's *biaohui*. “We can't even afford to send our children to school,” says a villager in tears.

It began in the traditional fashion, with small groups of people well known to each other. A typical *biaohui* would require members to give 100 yuan ($12) per month as a fee to the *biaohui* leader, who would then auction the right to use the money. The *biaohui* leader would normally enjoy the right to use the first monthly pool free of charge, but would be responsible for topping up the pool in the event of someone defaulting.

The system should work smoothly when everyone trusts each other. But if *biaohui* members become greedy for more interest, they become tempted to include members from outside their circle who would bid high at the start of the *biaohui*. Chinese press reports suggest that in Fuan, the growth of underground gambling syndicates and a hunger for capital in the booming electrical-machinery industry pushed up demand for high-interest funds. City dwellers, including officials, leapt on the bandwagon.

Members who had won an auction for pooled funds increasingly used the money simply to put into another *biaohui* with higher fees and thus, possibly, a bigger interest pool to share at the end. Within a few months, *biaohui* involving fee instalments of thousands of yuan grew rapidly, with some including more than a hundred members. To ensure quick returns, the period for payments was often shortened to weekly or even daily. When members of a big-stakes *biaohui* defaulted in May, the association leader was

unable to top up the pool, and the whole edifice collapsed.

In one of the looted villas, a couplet scrawled on a wall reads: “If you have a clear conscience, you will have nothing to fear when there is a knock on your door at midnight.” At least Fuan's bodyguard business is reported to be doing well.

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Egypt

New surgeon, same old scalpels

Jul 15th 2004 | CAIRO
From The Economist print edition

A new prime minister promises change, but he has only as much power as the president allows him

Get article background

BEING prime minister of Egypt is a thankless task. Like a doctor attending a chain-smoking diabetic, you are supposed to tackle such ills as swelling unemployment and rising budget deficits, but without exacerbating other chronic ailments, such as a palsied bureaucracy and spreading corruption. You have to do all this without inflaming those touchy organs, the army, the intelligence services, or the all-powerful presidency with its clinging appendage of business cronies. Worse, when your medicine fails to produce a miraculous cure, the blame falls on you, never on your boss, the untouchable president, or on the twisted constitutional scheme that stacks the odds against you.

So it was with a mix of pity and relief that Egyptians welcomed President Hosni Mubarak's appointment of a new man to the post on July 9th. Pity, because the outgoing prime minister, Atef Ebeid, had endured even more than the usual abuse during a five-year term marked by recession and policy drift. Relief, because the change this time was accompanied by a purge of other long-tenured and even less popular officials, and also because it ended a great wave of rumour-trading about Mr Mubarak's health. Last month, when he suddenly left the country for medical treatment in Germany, trading on Cairo's stock exchange virtually halted. Now, his slipped disc fixed, he is back to work.

There was also relief because the choice of the new team suggests that change is afoot. Along with nearly half the cabinet, half of Egypt's 26 regional governors, whom Mr Mubarak also appoints, were replaced. The presidency even answered longstanding pleas from journalists, among others, and named an official spokesman for itself, a move that may curb some of the Kremlinological excesses of Cairo's rumour mill.

To many, such moves hinted that Mr Mubarak, who seemed almost to enjoy ignoring pressure for change, now understands its urgency. Some see the hand of America behind this—noting the nudges from President George Bush, who said recently that the country which had led the region in peacemaking (and, after Israel, in receiving American aid) should also lead it in democratisation. Others see the influence of Mr Mubarak's ambitious, pro-business son Gamal, whose lobbying within the ruling National Democratic Party had so far been parried by reactionaries.

There was one sign of Gamal's influence in the new cabinet: its relative youth. Since the 1952 coup that created Egypt's veiled dictatorship, the average age of Egyptian ministers has crept up from the mid-40s to far beyond the mandatory retirement age of 60. The 82-year-old outgoing minister of justice slept through meetings. The ministers of agriculture and information, both ex-intelligence officers, had, like Mr Ebeid, served under the 76-year-old Mr Mubarak for 22 years, and had turned their fiefs into sprawling empires. But on the very day of the information minister's dismissal, the state television monopoly he long controlled snipped his name from the production credits.

The new prime minister, Ahmed Nazif, was the previous cabinet's youngest member. Born in the year and month of the army's takeover, he earned a doctorate in Canada before returning to Egypt in the 1980s to champion the spread of computer literacy. As minister of communications, one of his achievements was to back a programme to expand access to the internet that is considered a model for developing countries. In March, he accompanied Gamal Mubarak on a trip to America.

Fresh-faced Mr Nazif

Mr Nazif has created a dynamic-looking economic team by naming Yousef Boutros-Ghali, another competent youngster, as finance minister, and Mahmoud Mohieddin, a 39-year-old economist and henchman of Gamal Mubarak, to a new portfolio overseeing capital markets, privatisation and investment promotion. There is hope that this duo might consider serious reforms, such as privatising a bank or two. (State-owned banks control three- quarters of Egypt's liquid capital, which they allocate with ruinous ineptitude.)

Luckily, Egypt's economy has already started to recover, despite the mess elsewhere in the region. One thing Mr Ebeid did achieve was a much-delayed currency devaluation. With the predictable howl of popular fury subsiding, that has begun to produce the desired results. Tourism and other exports are booming, and the current account has shot into the black. The country is now seriously cheap: a ride on Cairo's metro costs the equivalent of ten American cents; a simple meal can be had for a quarter.

The downside is that this cheapness is partly sustained by state subsidies that have helped push domestic debt to dangerous heights, and that even so, some four-fifths of Egyptian families barely get by. Advertising agencies reckon that only 8m out of 70m Egyptians have disposable incomes worth chasing, compared to 40m in similarly-sized Turkey. Unemployment is also a worry. The pool of job seekers is growing by 1.2m a year, and the country must somehow digest a bulge of 15m youths who are now aged 15-24.

Technocrats, such as those in Mr Nazif's new government, may be able to handle these problems. Egypt has a lot going for it, if only it were managed right. The trouble is that like his predecessors, Mr Nazif will probably not be given the tools he needs to do the job. Would the security forces allow him to end arbitrary arrest and torture? And would the president's cronies allow subsidies to be cut, state ownership of the media to be ended, political parties to form and operate freely, or—heavens—the kind of real elections that create real mandates for real prime ministers?

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Iraq

Just another autocrat?

Jul 15th 2004 | BAGHDAD
From The Economist print edition

Authoritarianism, minus the authority

Get article background

THE war between Iraq's new government and its rebels is acquiring an Algerian flavour. Rebels disguised as police erect false checkpoints. Car-bombers drive police cars. A campaign of beheadings is prompting foreign contractors to flee. The Europeans who set up Baghdad's first mobile telephone service, for example, have largely left, and replacements have proven hard to find.

On July 14th, a bomb killed 11 at the gates of the government's fortified enclave in Baghdad, and a grenade killed the governor of Mosul. Clearly, it will be hard for the new prime minister, Iyad Allawi, to assert his authority.

AP

Let's do it my way, says Allawi

Mr Allawi is trying, however. He has dispatched soldiers to guard the roads into the capital, and police cars to cruise the streets. On July 12th his security forces rounded up, they say, more than 500 of the criminals freed from Saddam Hussein's jails before the war.

Some Iraqis crave a strongman. Others shudder at the parallels between Mr Allawi's new Public Safety Law and the rules Saddam used to wield. “What are the differences between this government and Saddam's?” thundered Sheikh Mahdi al-Sumayda, a radical Sunni imam.

Actually, there are several. For one, Mr Allawi's powers are constrained by President Ghazi al-Yawar, who insists he is no ceremonial pushover, and will veto laws he dislikes. He has the final say, he claimed this week, over strategic decisions on defence, foreign affairs, oil and industry.

Another check is that Iraq's regions, from the Kurdish north to the oil-rich south, are champing to do their own thing. For all his emergency powers, the prime minister has so far stepped softly in his dealings with rebels—a recognition perhaps that they cannot easily be crushed. At secret meetings, Mr Allawi has sought to cajole rebel leaders to join the new order. He mostly offers carrots, not sticks. Some rebels have been enticed to join the army by the prospect of regular pay. The government is expected soon to offer an amnesty that would apply even to some of the worst.

In some ways, Mr Allawi is acting like a traditional Arabian Gulf leader, patronising friends, buying off foes and chipping away at the checks and balances the Americans left behind. Now that Iraq is sovereign again, Mr Allawi's spokesmen say that occupation-era regulations no longer apply. The country's top Shia spiritual leader, Ayatollah Ali Sistani, agrees.

This is worrying. Some American-imposed laws, such as those placing coalition forces and foreign contractors outside Iraqi law, clearly served the hand that signed them. But others were carefully crafted to shield Iraq from a future dictator.

An independent council of judges, for example, was designed to appoint judges, a commission of public integrity to press charges against corrupt officials and a media and communication commission to share out Iraq's airwaves.

The commissioners were appointed before the handover, mostly for five-year terms. But Iraqi officials are now crying foul. America, they carp, has stuffed these bodies with foreign advisers who sometimes

refer callers to its own embassy. They plan to rule Iraq indirectly, just as the British once did, say some.

The government is considering sidelining the media commission and reviving the old Information Ministry. American-appointed governors of the state broadcaster are also, say officials, to be replaced.

The commissions themselves are resisting. Radhi al-Radhi, the heavily-protected commissioner for public integrity, is preparing to ask all civil servants to sign a code of conduct, and all senior officials to declare their earnings (including gifts). He also wants to name investigators to monitor what the prime minister's office and the presidency spend money on.

But the government controls Mr Radhi's budget, and has only now, after six months, started to disburse. Mr Radhi has so far played safe, concentrating his investigations on the Chalabi dynasty, which ran the finance ministry before the handover but has now fallen from favour.

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Iran and Iraq

Neighbour, and enigma

Jul 15th 2004 | TEHRAN
From The Economist print edition

The Iranians are blowing hot and cold in Iraq

Get article background

MUHAMMAD KHATAMI, Iran's president, insists that his country desires “stability and reconstruction” in neighbouring Iraq, but Iraqis are not so sure. Since Iraq's interim government took office at the end of last month, its foreign minister has berated Iran for not doing enough to stop fighters crossing their common border to join the insurgency. On July 5th, the Iraqi police said they had arrested two Iranians for trying to detonate a car bomb. Is Iran a maker or a breaker?

The answer may be a bit of both, in varying degrees. Keen on unity among their Shia brethren in Iraq, the Iranians helped broker an apparent accommodation between Muqtada al-Sadr, a Shia firebrand, and Ayatollah Ali Sistani, Iraq's top cleric. Iran is friendly with several members—not all of them Shia—of the new government, provides aid to poor Iraqi Shias and (when the roads are safe) sends up to 10,000 pilgrims a day to Iraq's holiest sites.

Shia Iran stands to lose from an insurgency that finds recruits among militant Sunnis. On the other hand, as one-third of George Bush's “axis of evil”, Iran fears that signs of American success in Iraq would embolden hawks in Washington to seek new targets. So, in Tehran, hardline newspaper editors and Al-Alam, a state-run Arabic television channel, lionise the insurgents. Iranian border guards may well be as lax as the Iraqis claim.

Two recent events have sharpened Iran's opposition to the occupation. In May, the intensification of fighting in Shia shrine cities prompted state-organised mobs in Tehran to hurl petrol bombs at the British embassy. Egged on by Iran's conservative establishment, several thousand volunteers declared themselves ready to die to rid Iraq of the occupiers.

For the main cause of Iran's growing obstreperousness, however, look to Vienna. There, on June 18th, the board of the International Atomic Energy Agency (IAEA) issued a resolution castigating Iran for failing, yet again, to shed enough light on its secretive nuclear programme.

Bowing to international pressure, the Iranians had earlier promised “temporarily” to stop uranium-enrichment and producing centrifuge machines, though they never entirely stopped making parts for them. They had lobbied IAEA members for a friendly resolution. They mostly blamed Britain, one of three European sponsors of a tough resolution, and the United States for dashing their hopes.

Foreign diplomats in Tehran detect a link between the resolution and Iran's seizure, less than a week later, of eight British servicemen who had allegedly strayed across Iraq's fluvial border with Iran. The detained Britons later accused Iran's Revolutionary Guard of forcing them into Iranian waters. Whether or not this is true, the Iranians were certainly conveying a message. That message was partly directed at those Arabs who berate Iran for co-operating with Iraq's occupiers; Al-Alam beamed suspiciously instantaneous accounts of the contretemps to viewers in Iraq and elsewhere. Mostly, though, it was a warning to America and Britain.

In Tehran, a well-connected foreign-affairs analyst advises the British to “ask themselves why Basra [the biggest city in Iraq's Shia south] has hitherto been calmer than many other parts of Iraq”. The allies, he believes, would be unwise to expect the Iranians to exercise a calming influence over Iraqi Shias while they haul Iran over the coals on the nuclear issue.

Iran's politics are increasingly dominated by conservatives who seek to unnerve countries that they

regard as their nuclear tormentors. Having announced their decision to restart centrifuge-manufacture, Iran's leaders may balk at the even more provocative gesture, advocated by hardliners in parliament, of resuming uranium-enrichment. Across the border, there are plenty of ways to express their displeasure less overtly.

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Democratic Republic of Congo

Four rebels and a funeral

Jul 15th 2004 | BETWEEN UVIRA AND BARAKA
From The Economist print edition

Why the Church is Congo's most respected institution

THE rutted track that links the towns of Uvira and Baraka in eastern Congo is known by locals as “the road through Hell”. The rebels at its many checkpoints are larcenous and usually drunk before noon. They also dislike journalists, so your dishevelled, Panama-hatted, crucifix-wearing correspondent was pleasantly surprised to be mistaken for a priest. Clerics are popular in Congo; even the roughest rebels would hesitate to shoot one.

After five years of civil war and centuries of neglect, many Congolese reason they must be due a better life in the next world. The Church offers hope. It is also one of the few institutions in Congo that still functions roughly as it should. The state has mostly rotted away, and much of what is left is predatory. In much of the country, the only schools are church schools, the only clinics are staffed by nuns, and the people who speak up the loudest for the poor and pistol-whipped are the priests.

This is true in less troubled parts of Africa, too. The Church has had its moments of shame: during the Rwandan genocide, for example, some priests herded parishioners into their churches and murdered them. But generally, the clergy are respected. Presidents often seek their guidance, and chafe when they chide. Robert Mugabe of Zimbabwe was so furious to be criticised by Desmond Tutu that he called him “an angry, evil and embittered little bishop”.

Africa has plenty of home-grown clerical talent: a Nigerian is tipped as the next pope, and the continent exports missionaries to Europe. But Africans still like to hear foreign preachers. American evangelists draw huge crowds in Kenya, for example, and thrill them with lucrative displays of “faith healing”.

Your correspondent was not asked to heal the sick, but he was told to perform the last rites on one of those Congolese rebels' slain comrades. Thinking it unwise to refuse, he dredged up his best schoolboy Latin. The rebels, their combat caps clutched to their chests, listened in respectful silence to badly-scanned snatches from Virgil's *Aeneid*.

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Israeli politics

The two old foxes

Jul 15th 2004
From The Economist print edition

Why Sharon and Peres may be getting together again

Reuters

Two old men plan a pullout

THEY first met about 50 years ago as rising stars in Israel's growing defence establishment, young disciples of David Ben-Gurion, the state's founding father. Since then, Ariel Sharon, now aged 76, and Shimon Peres, now 80, have shared long careers in Israeli security and politics, sometimes as bitter rivals, sometimes as convenient collaborators, but always preserving personal friendship and mutual appreciation. On July 12th, the two old foxes met for breakfast, looking for a way to renew their partnership in a “national unity” government. It would be a government with a single agenda: to realise Mr Sharon's plan to pull troops and push settlements out of Gaza and parts of the northern West Bank late next year.

The prime minister and opposition leader share political needs. Mr Sharon lost his far-right coalition partners after the cabinet approved his plan in principle last month. Ruling with a minority government of 59 of the 120 Knesset members, he finds it difficult to run things properly. The opposition has, twice in a row, forced a no-confidence stalemate. This was more an embarrassment for the prime minister than real political jeopardy: to topple him, a majority of Knesset members must present an alternative candidate, and they would have difficulty in agreeing on one. Mr Sharon may survive for a while. But with the budget vote looming in October, and the need to bring his “disengagement” plan to final approval next March, he must either widen his parliamentary base, or gamble on early elections.

Mr Peres's Labour Party would be the best partner he could get, given its size and its strong support for leaving Gaza. Mr Sharon would also like to see Mr Peres as foreign minister, using his international clout to steer the country away from its growing isolation. This was shown up last week when the International Court of Justice in The Hague ruled against Israel's security barrier in the West Bank, declaring it illegal and demanding its destruction (under an order from Israel's own Supreme Court, the government is already moving part of the barrier closer to the border between Israel and the occupied territories).

Mr Peres, for his part, is facing a deadline. The Supreme Court decided last week that the next election should be held by November 2006, a year ahead of schedule. This shortens Mr Peres's tenure as Labour leader, and he would rather take the foreign minister's job for the fourth time than fade out in opposition. His policy differences with Mr Sharon over the withdrawal plan are, in fact, minimal. He demands a firm timetable, and would like to see it co-ordinated with the Palestinian Authority. Mr Sharon could accept this.

But despite their closeness, Israel's elderly couple are having difficulties getting remarried. Ideological opponents of withdrawal within Mr Sharon's own Likud party recoil from embracing Labour. So does the current foreign minister, Silvan Shalom, a strong party operator, who would have to give his cherished position to Mr Peres. To overcome these objections, Mr Sharon is threatening his 40-member party with an early general election, which could cost Likud several seats. He has also approached the ultra-religious parties, though bringing them on board would be at least as complicated.

Once again, Israel is in the familiar territory of political turmoil. Mr Sharon still has a bit of time for manoeuvring: he has until October, when the Knesset returns from its summer recess to choose between a unity government and a new election. True to form, he will probably wait until the last moment to decide.

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Ethiopia

People aren't cattle

Jul 15th 2004 | ADDIS ABABA
From The Economist print edition

Is mass resettlement really the way to solve Ethiopia's food shortage?

AS TECHNIQUES for boosting farm yields go, loading peasants into trucks and resettling them far from home has been conspicuously unsuccessful in the past. Stalin killed millions in the process. Ethiopia's former Marxist dictator, Mengistu Haile Mariam, was slightly less ruthless, but only slightly. In the 1980s, he gave some 570,000 people the choice of moving or being shot. Parents and children were sent to opposite ends of the country. Many found life in their new areas intolerable, tried to walk home, and perished en route.

Odd, then, that the present Ethiopian government, whose leaders overthrew Mengistu in 1991, should be attempting something that sounds quite similar. Fed up with their humbling annual appeal for food aid, they have started moving more than 2m peasants from dried-out plots in the highlands to fertile soil in the west of the country. The hope is that these farmers will, at last, be able to feed themselves. The timescale for this ambitious scheme is just three years.

AFP

Far from home and hungry

Ethiopia has to do something to help its hungry peasants. The country is chronically short of food: about 5m Ethiopians, out of a population of 70m, need food aid in a typical year. In last year's drought, 13m did. But is mass relocation the answer?

The government insists that its scheme is quite unlike previous ones. For a start, it is strictly voluntary. But what does this mean, in practice, in a country with such a long history of autocracy? The officials who administer the scheme are used to giving orders, and Ethiopian peasants are used to doing what they are told. The government says that those who don't like their new homes can go back; but that can mean walking hundreds of miles across parched savannah. The government says it makes no sense to allow much of the country's best soil to lie fallow while farmers struggle to squeeze a living from minuscule, dust-blown fields.

Settlers seem to be doing well in places such as Tigray in the north, where the authorities have provided strong support since the scheme was launched last year. But the early signs in other places are more worrying. Some 300,000 people have been resettled so far, many in the southern Oromia region, where it has proved particularly hard to subsist.

Frustrated farmers complain of a lack of help in setting up viable villages. Besides large plots of land, the government promised them schools, credit and farm tools, but often failed to deliver. Mothers clutch sickly children, pining for milk from the cows they left behind. Even youngsters with vast experience of hardship appear miffed at having to share one blanket between ten. In many areas, planting started late or not at all. The farmers say they want to stay, but if things don't improve, they will consider leaving. A few have begun trickling home.

Meles Zenawi, the prime minister, admits that the scheme is not going smoothly and that his regime does not have the more than $200m he thinks is needed to make it work. He says it is up to donors to support it. But they are reluctant. They worry that the scheme is too *dirigiste* and will provoke clashes between locals and newcomers, as Mr Mengistu's scheme did. The government retorts that it will only move people to areas with a similar ethnic mix. Fair enough, but if there is so much attractive wilderness up for grabs, why haven't farmers already ploughed it up? In a word: malaria. Many fertile lowland areas are swarming with deadly mosquitoes.

Ethiopia might do better to focus on making farming more profitable on existing holdings. Top of many reformers' wish-list is secure individual land tenure. By law, all Ethiopian land is owned by the state. Farmers are loth to invest in improving productivity when they have no title to the land they till. Nor can they use land as collateral to raise credit. And they are taxed so heavily that they rarely have any surplus cash to invest.

Mr Meles is said to be pondering the idea of promoting private property rights, but the conventional wisdom among his officials is that, if peasants could sell their land, they would do so immediately, drink the proceeds and head for the cities, where they would become an unsightly and potentially disruptive underclass.

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French politics

Nicolas Sarkozy and the reform of France

Jul 15th 2004 | PARIS
From The Economist print edition

AFP

The tale of a man who is now at the centre of France's government

Get article background

HE IS an old-style interventionist, but a free-market critic of the 35-hour week. He is a defender of national champions, but has pushed the commercialisation of the state electricity utility. He tries to control prices by negotiating with supermarkets, but uses competition to do the job in telecoms. Part meddler, part economic liberal: who is Nicolas Sarkozy? The French finance minister, and his warfare against President Jacques Chirac, mesmerises France. This week a job vacancy opened at the Union for a Popular Movement (UMP), the party Mr Chirac created, when Alain Juppé stepped down as chairman, having been convicted of political corruption. Despite Mr Chirac's best efforts, the man ready to take over is Mr Sarkozy.

Most UMP deputies—80-90%, says one backbencher—back Mr Sarkozy for the job, which could be a springboard for a 2007 presidential bid. Asked by Ifop, a pollster, 49% of voters prefer Mr Sarkozy to 41% for Mr Chirac. Among right-leaning voters, the gap is 62% to 33%. The man whom Mr Chirac has distrusted ever since he backed a rival, Edouard Balladur, in the 1995 presidential election, is riding a wave of popularity that may end in confrontation. These days “Les Guignols de l'Info”, a satirical television show, shows Mr Sarkozy burying Mr Chirac alive. This week, Mr Chirac again said he would not let Mr Sarkozy run both the UMP and the finance ministry.

In many ways, Mr Sarkozy's appeal is that he embodies everything Mr Chirac is not. The president is of an older generation, trained at the Ecole Nationale d'Administration (ENA) to believe in a well-run state, the primacy of the Franco-German relationship and a version of neo-Gaullism that draws heavily on anti-Americanism. He was first elected in rural Corrèze, and is still beholden to farmers. His wife Bernadette is a French aristocrat who stands loyally by her man. He is a baby-hugging campaigner in the populist mould, but, after nearly ten years as president, has perfected *la langue de bois*, a form of bland political evasion. A survivor not a reformer, Mr Chirac is a classic product of French technocratic tradition.

Mr Sarkozy, by contrast, is all flashy modernism. Aged 49 to Mr Chirac's 71, he did not go to ENA, but trained as a lawyer. He came of age politically in the Thatcherite 1980s, when statist policies went out of fashion. He treats Germany as no more privileged a friend than any other, and works hard at alliances with Britain, Spain and America. Where Tony Blair and Mr Chirac clash, Mr Sarkozy is close to the British prime minister and to Gordon Brown, his chancellor. (Mr Sarkozy's stepdaughter is at university in England.) As interior minister, he resisted the ban on the Muslim headscarf in state schools, embracing

instead Anglo-Saxon multiculturalism. He admires America's social mobility.

Also unlike Mr Chirac, Mr Sarkozy's political life began far from rural France, in Neuilly, a bourgeois Paris suburb of which he was mayor. With his high-profile wife, Cécilia, who works in his private office, they form a power couple more in the Blair or Clinton mould. The son of an aristocratic Hungarian immigrant, he has an outsider's drive. What he lacks in height he makes up in hyperactivity, expecting long hours from his advisers and blowing up at any slip-ups. He is often photographed cycling or jogging, as if to ram home the contrast with an older president.

Above all, Mr Sarkozy rejects old excuses for not reforming France. “The obstacle to change in France is a lack of political courage,” he says, relaxing on the ministerial jet back from a recent trip. If you explain what you are doing, and why, he argues, the French will change. Look at how his policy of pushing speed cameras moderated breakneck driving. A child of the television era, with a taste for showmanship, he knows how to use the media: he gets a far better press than the unpopular prime minister, Jean-Pierre Raffarin. Hence his weekly trips to factories or supermarkets, the point being to popularise change. He presents reforming the 35-hour week in terms of putting more money in workers' pockets; budget cuts as just good housekeeping. Tellingly, he admires Bill Clinton.

If Mr Sarkozy is so keen to modernise France, though, why his nationalistic noise over bailing out Alstom, a French firm, or insisting on a French merger partner for Aventis, a Franco-German drugmaker? This looks like incoherence, if not political weakness. Even turning Electricité de France (EDF), a bastion of Communist-backed unionism, into a company ahead of partial privatisation was sweetened with concessions. An explanation advanced by his aides is that Mr Sarkozy must tread a delicate path between symbolic populist gestures, such as saving jobs at Alstom, and unpopular reforms, such as commercialising EDF. “You don't get elected in France by praising markets,” comments one adviser. In other words, populist concessions earn him the credibility to press on with more liberal measures elsewhere. “I do what works, what makes things move,” says Mr Sarkozy, dismissing efforts to pin labels on him.

Aware that brutal reform has buried past ministers, Mr Sarkozy picks battles pragmatically. The next will be the forthcoming budget. He wants to prove that the French can keep their word, and bring their deficit below 3% of GDP in 2005. He has re-opened a debate over the 35-hour week (see article), and he wants to make the European Central Bank more transparent and accountable. Strikingly, he has just appointed a free-market economist as an adviser. Yet the balance of evidence so far is not in favour of Sarkozy-as-liberal. A test will be whether he can stick to his word on the budget, and also pull off labour-market reform. The spending round will be tough, given Mr Chirac's new fondness for “social” programmes. But that, as Mr Sarkozy concedes wryly, is probably why he was offered the job.

Much depends on how long he stays at the finance ministry. If Mr Sarkozy stands for the UMP chairmanship, which he must do by mid-September for a vote in November, will he defy the president and keep both jobs? Mr Chirac was once prime minister, head of his party, and mayor of Paris. Would Mr Chirac really fire his most popular minister if he refused to go?

For all the sense that Mr Sarkozy represents a refreshing alternative to Mr Chirac, high office might yet temper his reputation. The media circus that surrounds him, his insistence on the pomp of office, his hunger for the presidency: perhaps the pair are not so different. In the 1980s, an upcoming young politician on the right, whose energy wowed the French, yearned for the presidency. He talked powerfully about the need to modernise France, liberalise the economy and bring in change. He was dynamic, worked long hours and persuaded ordinary people he was on their side. In short, he was like Mr Sarkozy. His name? Jacques Chirac.

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France and the 35-hour week

Change on the way?

Jul 15th 2004 | PARIS
From The Economist print edition

EPA

The notorious 35-hour week is coming under increasing attack

NOT since nationalisation in the early 1980s has a single policy so embodied French wrong-headedness. The 35-hour week, brought in by the Socialists in 2000-02, cut the maximum working week by four hours with no loss of pay. It was meant to create jobs. What has it actually done?

Three points stand out. First, big companies have coped better than small ones, for whom the rules have been eased. But even big firms feel that any benefits have worn off. Renault secured flexible working practices—weekend shifts, night work—in return for a shorter week; Caterpillar, a big American firm, moved to seven-day working. But four years on, the complaint is that the policy has destroyed the work ethic and damaged productivity. Insee, a statistics body, says it cut output per head by 5% between 1999 and 2002.

In labour-intensive services, the 35-hour week has brought mayhem as well as extra costs. A French bank boss calls it an “immense folly”. It is not just the 25% overtime pay for hours worked over 35, rising to 50% above 44 hours; it is also productivity lost to absences. In return for not having a 35-hour week, “autonomous executives” get ten or more extra paid days off a year. Short weeks make projects unmanageable. “It's like working with a permanent team of part-timers,” complains one insurance boss. He cites a colleague who refused a promotion because he would lose extra days off. Oddly, absenteeism has also risen.

Second, the 35-hour week has created a two-tier labour market. Its chief beneficiaries are not workers, whose pay has been frozen for two or three years. Rather it is the autonomous executives, with their extra days off. And thanks to broader labour-market rigidities employers are using short-term or temporary contracts to gain flexibility. By 2002, some 22% of those under 25 worked on such contracts, up from 13% in 1992.

Third, the promise of job creation was empty. Martine Aubry, architect of the 35-hour week, says it “created 450,000 jobs”. Certainly, the public sector had to create many, at heavy cost. Yet the policy came when the economy was buoyant. The government cut employers' social charges, which would have created more jobs anyway. And France's jobless rate is still nearly 10%—twice that in Britain—and 22% for under-25s.

Is all this sinking in? A poll in *Le Parisien* suggests that 51% favour reforming the 35-hour week—if they can earn more. Bosch is negotiating a 36-hour week at its plant near Lyons. Nicolas Sarkozy, the finance minister, is pushing for reform. It may not mean the death of the 35-hour week, which unions would resist. But the wisdom of forgoing higher pay for more free time is being questioned.

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Labour reforms in Germany

Bargain basement

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The trade unions are left with little room to negotiate

Get article background

WORKERS at DaimlerChrysler plants in Germany took a “day of action” on July 15th to protest against proposed wage cuts and longer working hours. Yet if the carmaker cannot reduce labour costs by €500m ($600m) a year at its Sindelfingen plant in south-west Germany, it threatens to move production of the C-class Mercedes to Bremen (where staff work slightly longer hours), or to South Africa. This is only one of many poker games being played by German firms with unions as they seek to cut labour costs.

In today's economic climate, the bosses seem to be winning. Last month Siemens got the nod from the biggest blue-collar union, IG Metall, to raise its working week from the standard 35 to an average of 40 hours at two plants near Cologne. The argument was that this would save 2,000 jobs that would otherwise shift to Hungary. Siemens can now impose similar conditions at other plants under threat.

The 35-hour week, established in western Germany in the late 1980s and early 1990s, is still insisted on publicly by IG Metall and Verdi, the biggest white-collar union. But threatened plant closures and other hard-luck stories have forced concessions at, for example, Continental, a tyre company, and ThyssenKrupp, a steelmaker. Volkswagen is preparing for a showdown to cut labour costs by 30%.

Germans work fewer hours per year than workers in any other rich country except the Netherlands and Norway, according to the OECD. At DaimlerChrysler's Sindelfingen plant the workers get a five-minute break every hour. With that and local holidays they work 72 hours less per year than colleagues in Bremen. Lengthening the working week is a less painful way of cutting costs than trimming wages, even if it makes it little easier to find jobs for Germany's 4.4m unemployed.

That challenge is the focus of another labour-market reform that has just passed into law. Hartz IV, as it is called, merges social-security payments with the unemployment-benefit system. That may sound like paper-shuffling but it is, claims Matthias Platzeck, premier of Brandenburg, “the biggest social revolution in Germany since the second world war.” From January, the long-term unemployed, whose lives have been too cushy, will find the tap turned off if another household member is in work, or they have too many assets, or they are unwilling to take jobs offered.

It will be hard for any of these measures to make a big difference in places with high unemployment: in eastern Germany, for instance, average unemployment is 18.5% and there are areas where it is closer to 30%. But everywhere, say the polls, there is a growing readiness to be flexible to save jobs, including working longer hours. Perhaps not as long as Jürgen Kluge, who heads the German arm of McKinsey, and recently claimed to work between 70 and 80 hours a week. But the relentless fall in hours worked in Germany seems likely to be reversed over the next few years.

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The European Union's troubles

Stability and instability

Jul 15th 2004 | BRUSSELS AND PARIS
From The Economist print edition

Fights loom over the constitution, the budget and the stability pact

Get article background

PRESIDENT JACQUES CHIRAC chose July 14th to announce that France would, after all, hold a referendum on the draft European Union constitution, probably in the second half of 2005. It was time, he said, to “bet on Europe”. With an unpopular government and uncertainty in France about today's EU of 25, this could be a big gamble. But in truth Mr Chirac had little choice. He was cornered abroad, notably by Tony Blair's decision to have a referendum in Britain, a move that hugely upset Paris. At home, he was under pressure from his own party. The prime minister, Jean-Pierre Raffarin, and the finance minister, Nicolas Sarkozy, had both come out for a referendum. Besides, direct consultation is a fifth-republic tradition: there have been nine referendums since 1958.

The risk, as with all referendums, is that the French may not answer the question. In 1992, they almost sank the Maastricht treaty, backing it by a wafer-thin 51-49%, mainly because of discontent with the Mitterrand government. Mr Chirac's government is also unpopular. And the opposition Socialist Party is split on whether to back the constitution. Mr Chirac's best hope is that the French might prove more enthusiastic than they seem. A TNS-Sofres poll in May suggested that 72% of voters backed the idea of a European constitution, and 67% were positive about Europe.

Even so, a referendum in France must increase the odds that the constitution will never be ratified. At least nine other countries are holding votes. The trickiest may be in Poland and Britain. And a further development this week may make a British referendum even harder to win: the European Commission's confirmation of its proposals to phase out the British EU budget rebate. Britain immediately declared that the rebate, famously negotiated by Margaret Thatcher in 1984, was “unnegotiable”. Since any change requires a unanimous vote, the British may be able to prevail. But they will be in a minority of one against 24—and the fight is likely to be going on at the same time as a vote on the constitution, encouraging a no vote.

Yet another problem for the constitution may stem from the EU's notoriously misnamed stability and growth pact, which supposedly limits budget deficits of euro-area members to below 3% of GDP. Last November, to the great irritation of smaller countries, the French and Germans persuaded a qualified majority of their fellow governments in the Council of Ministers to reject the commission's proposal to threaten sanctions against the pair, and instead to put the entire pact into abeyance. But this week the European Court of Justice ruled that the council had exceeded its powers.

The judgment, which had been sought by the commission, was hailed as a victory for Brussels over national governments. But that interpretation merits closer scrutiny. It has long been a truism of European politics that, when the commission gets into a fight with national governments, it is the commission that comes off worse. And, although the judges annulled the decision to put the pact in abeyance, they also said that the council's failure to adopt the commission's recommendations was not something they either could or should overrule. Thus the court's decision is unlikely actually to change French or German fiscal policy: it will remain possible for the council to ignore any new recommendations for sanctions that the commission may make.

More likely than a fresh proposal for sanctions is a fresh set of negotiations. The commission will discuss with governments some form of revised recommendations with which all can live. In short, a purist interpretation of the pact will be displaced by the real world of political fudge. And, further ahead, the terms of the pact itself may yet be watered down. The commission plans to make proposals for revising the pact in September.

How, one might ask, could any of this affect the EU constitution? The answer lies in the Dutch referendum that will be held early next year. The Dutch were by far the angriest at the let-off for France and Germany. When they realise that, even after the court ruling, the French and Germans are unlikely to suffer sanctions, the feeling that there is one rule for the big and another for the small may strengthen Dutch Euroscepticism (see article).

In short, it has been a bad week for the EU constitution—and maybe for the future of the EU itself.

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Central Europe's economies

A rising tide

Jul 15th 2004 | WARSAW
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Economies are growing, but reforms are needed to keep them that way

A STRENGTHENING economy has lifted the Polish mood from the depths it plumbed when Leszek Miller and his sleaze-plagued government resigned three months ago. GDP growth may even beat early forecasts by topping 6% this year, Poland's best performance since 1997. Other central European countries are doing well too. Accession to the European Union on May 1st has removed the last few barriers to trade for all eight new central European countries, and given a lift to flagging foreign direct investment (FDI). The Vienna Institute for International Economic Studies says it expects the eight to attract 50% more FDI this year than last.

Poland's growth is rising fastest in this upswing, mainly because depreciation of the zloty has kept labour costs down. Even farmers are cheering up, because EU entry has meant new markets and higher prices for beef and other products, says Katarzyna Pietka of CASE, a think-tank. Things could be a lot worse for Marek Belka, Poland's new prime minister; his minority government has a chance of staying in office until elections due next year. Mr Miller may even wish he had held on longer.

Yet a grimmer picture is painted in a new survey of Poland by the OECD. The structural problems of the Polish economy, it says, still need fixing. Foremost is a labour market that the OECD calls the worst-performing in all its 30 rich-country members. Only 51% of the working-age population is in employment, against 56% in Hungary, 58% in Slovakia and 65% in the Czech Republic. High payroll taxes, a minimum wage and restrictions on firing workers all deter hiring. Ill-targeted welfare schemes encourage able-bodied people to stay at home, or on the farm, since farm-workers get especially generous treatment. Agriculture accounts for one-fifth of employment, but only 3% of GDP. Getting rural folk into more productive jobs could add 30% to Polish output, says the OECD.

Poland's ex-communist neighbours share similar problems. All have inherited welfare states and entitlement cultures that eat up public money. All have subsidised workers pushed into unemployment or early retirement by the collapse of communist-era industry. Most have big budget deficits. Poland's has reached 6-7% of GDP, pushing public debt close to its legal limit. Hungary's deficit topped 9% in 2002, unnerving markets, but a change of finance minister has restored confidence. Concern has moved on to the Czech Republic, where the IMF in May attacked “inaction in some key policy areas”. Since then the government has collapsed, and a new one may be no better. Czech growth may be the lowest in the region this year, and its budget deficit one of the highest.

Poland matters most, because it has a bigger population and GDP than all its central European neighbours put together, and because its politics are as wobbly as its economy. In European elections last month a populist farmers' party called Samoobrona (Selfdefence), and a right-wing Catholic anti-EU party, the League of Polish Families, took 26% of the vote between them. The entry of either into government could seriously damage Poland's already testy relations with the EU.

This explains why some Polish business leaders are reconciled to letting economic policy drift aimlessly for a few months under Mr Belka. They think this is less risky than an austerity drive that could bring down the government and raise support for the populists, says Henryka Bochniarz, president of the Polish Confederation of Private Employers. The hope is that recovery will drain support from fringe parties and

shore up moderate ones in time for an election next year.

Any new government will face pressure to deregulate the labour market, cut benefits, sell industries still in state hands and spend some savings on better roads. A tall order: but the alternative will be stagnation and fiscal crisis. The example of Slovakia gives hope. After radical fiscal and labour-market reforms five years ago, Slovakia enjoys booming inward investment, strong export growth, rising domestic demand and a rising currency. Poland can either follow or flounder.

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Portugal's new prime minister

Here comes the mayor

Jul 15th 2004 | LISBON
From The Economist print edition

Pedro Santana Lopes takes over from José Manuel Barroso

PORTUGUESE voters feel snubbed. Two prime ministers in a row have quit before delivering promised reforms. Now that José Manuel Barroso has become president of the European Commission they are to have another, whom they have not even elected: Pedro Santana Lopes, mayor of Lisbon.

Mr Santana Lopes's victory in 2001, when he promised a swimming-pool in every neighbourhood, was but a step in the career of a right-leaning populist who exasperates the Portuguese left. His manoeuvring ahead of the 2006 presidential race has attracted more attention than his work as mayor. He became vice-president of the Social Democrats, the dominant party in the centre-right government. When Mr Barroso quit for Brussels, he duly put forward the dapper Mr Santana Lopes as a successor. Yet Mr Barroso and Mr Santana Lopes are old rivals. Mr Barroso has defended the party's social-democratic traditions against the more conservative tendencies of Mr Santana Lopes.

To a moderate socialist like President Jorge Sampaio, the mayor stands for everything his party is against. That is why many urged the president not to give him the job but to hold elections instead. In the end, Mr Sampaio decided that asking Mr Santana Lopes to form a new government would be less damaging than plunging the country into elections two years early. But the president has urged Mr Santana Lopes to press ahead with the reforms Mr Barroso left unfinished, and to sustain fiscal rigour in the face of a soaring budget deficit.

Is he up to the job? José Pacheco Pereira, a critic from his own party, believes not, saying it is “inevitable he will undo the little” that Mr Barroso achieved and try to spend his way to re-election. Others liken Mr Santana Lopes to Italy's Silvio Berlusconi, minus money and media. His only government experience is as a junior minister in the 1990s. What can be expected, says José Manuel Fernandes, editor of the newspaper *Público*, are surprises, such as Mr Santana Lopes's 1998 announcement that, tired of media gossip about romances and nightclubs, he was quitting public life. A few months later he was elected to the European Parliament, confessing that his love of politics was too strong. It needs to stay that way, for the voters are not in a mood to be spurned again.

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Charlemagne

Dutch distemper

Jul 15th 2004
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A surprisingly sceptical Netherlands has just taken over the European Union presidency

WHATEVER happened to the good old reliable Dutch? Where the British tend to agonise and the French to preen, the Dutch have always epitomised a pragmatic, unfussy embrace of the European project. In the 1950s the Netherlands was one of the six founders of what has since become the 25-country European Union. In the 1990s two treaties that pointed towards “ever closer union” were signed in the Netherlands, after successful Dutch EU presidencies. The Maastricht treaty of 1992 laid the groundwork for a single currency and a common foreign policy; the Amsterdam treaty of 1997 deepened integration in judicial and monetary matters.

Another Dutch half-yearly presidency has just begun, but this time there will be no push for deeper integration. For there has been a marked change of mood in the Netherlands. Ben Bot, the Dutch foreign minister, recently gave a speech at Humboldt University in which he argued that the EU had developed too fast for many of its citizens and that a crisis of legitimacy was causing ordinary people to worry about a “loss of national identity” and to yearn for “the familiar old world, the nation state”. He went on to call for some powers to be repatriated from Brussels to national capitals, including social policy and some parts of farm and regional support.

Admittedly, the Dutch government has endorsed the draft EU constitution, but it has also made clear that it should bring to a halt the process of integration for some time to come. The Dutch programme for its presidency is almost British in its scepticism. When Jan Peter Balkenende, the Dutch prime minister, visits the European Parliament next week, he will focus on reducing bureaucracy and sparking economic growth. A stress on practical matters at the expense of new visions makes sense, given that the EU has just drawn up the new constitution. But the Dutch programme reflects more than an accident of timing.

The new mood in the Netherlands can be traced in large part to the political revolution sparked by Pim Fortuyn, an anti-establishment populist, whose combination of anti-immigration rhetoric and flamboyant social and economic liberalism helped to turn Dutch politics upside down in 2002. Mr Fortuyn was assassinated, and the political party he founded has since all but collapsed. But his legacy has been profound. In the post-Fortuyn era, politicians have become more willing to question the old Dutch certainties on everything, from the virtues of multiculturalism to the merits of consensus management.

Fortuynism fits too with a more sceptical attitude to the EU, one that is shared to some degree even by the Dutch European commissioner, Frits Bolkestein. The idea that Brussels is a cesspool of corruption has almost become an orthodoxy in the Netherlands. A “clean-up Brussels” party, led by a Dutch former EU auditor, did well in last month's European elections. And the new scepticism has also made it politically acceptable for the Dutch to complain long and loud about the fact that they are the biggest net contributor per head to the EU budget. Mr Balkenende says that the average Dutch citizen pays, net, six times as much into the EU budget as the average Frenchman, even though the two countries are equally rich. His finance minister, Gerrit Zalm, cites Margaret Thatcher as an inspiration in fighting for a better financial deal. The late Pim Fortuyn used to say the same.

Dutch grumpiness with Europe has been greatly aggravated by arguments over the euro and Iraq. The Dutch exchanged their ancient currency, the guilder, for the euro with scarcely a murmur of protest. But the sight of Germany and France flouting the budget-deficit ceilings of 3% of GDP supposedly fixed by the stability and growth pact, even as a recession-hit Netherlands struggled to stay beneath them, has sparked Calvinist outrage. The Dutch have been trying, largely in vain, to tighten the rules. The European Court of Justice ruling in favour of the European Commission on July 13th may give the Dutch a new opportunity to assert the case for fiscal austerity, even though they are themselves in danger of going above 3%. But their irritation with Germany and France, fellow founders of the EU, goes wider. The

French and Germans led the European camp opposed to the Iraq war, but the Dutch lined up with the British and the Americans. Some 1,300 Dutch troops are now serving in Iraq.

Until a few years ago, there would have been little doubt that, in any fundamental debate about the future of Europe, the Netherlands would line up with France and Germany. But the new mood in the Netherlands make this far less certain today. One senior EU official comments that “if the EU splits and Britain leaves, it will be a particular disaster for the Dutch. Half of the country will want to go with Britain, the other half will want to go with France and Germany.”

Might the Netherlands say no?

The Dutch might not be victims of an EU crisis: they could precipitate one. For the Netherlands is one of ten countries that have promised to hold referendums on the new constitution. A Dutch no would in some ways mark a more profound crisis for the EU than a British or Polish rejection. To be sure, Britain is a big country, but it has always been part of the awkward squad. If the sensible Dutch start turning up their noses at an EU treaty, it would be final confirmation that Euroscepticism has spread from the Anglo-Nordic fringe to the very heart of the Union.

Dutch ministers now reckon that their vote is likely to be held in spring 2005, and they seem genuinely optimistic that it will be won. Mr Bot points out that all the main political parties have endorsed the new constitution, and that the press has been positive. But the same factors were in place both when Sweden voted on the euro and before Denmark's first referendum on Maastricht—and yet in both cases the no camp won the day. Could it happen in the Netherlands? In the post-Fortuyn age, nothing can be taken for granted.

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Public spending

The firing line

Jul 15th 2004
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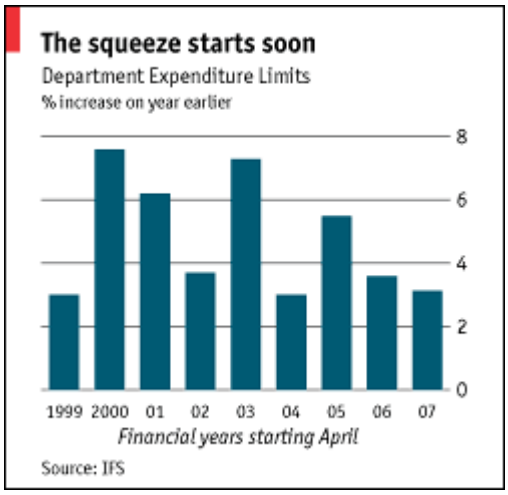
The chancellor needs money, and says he can find it by slashing the civil service

WHEN Tony Blair is up, Gordon Brown tends to be down, and vice versa. So it was this week, when the prime minister had a hard time over Iraq, and the chancellor seemed to have pulled off an impressive coup announcing what the government would be spending over the next three years.

Mr Brown had a problem. The government has staked its future on improving public services, and has been flooding them with cash since 2000, but has run out of money to pay for much in the way of further improvements. The sorry state of the public finances, with a deficit of £37 billion ($68.5 billion) in 2003-04, has forced economies on the chancellor (although not until the general election expected next summer is out of the way).

Unveiling new spending plans on July 12th, Mr Brown claimed that they would maintain "the longest sustained investment in public services for a generation". In reality, he was announcing an end to the six-year spending splurge on those very services. His announcement that departmental budgets would rise at an annual rate of 4.2% in the three years to 2007-08 disguised a slowdown in 2006-07 and 2007-08 (see chart).



What's more, much of the extra money is going to the National Health Service (NHS) whose budget rises at an annual rate of 7% in the two years to 2007-08. With the education department getting a 3.5% annual increase over the same period, spending by all other departments rises by only 1.5% a year, according to the Institute for Fiscal Studies (IFS), a think-tank that specialises in taking Mr Brown's sums apart.

If the years of big spending increases are over, so, presumably, are the years of big increases in resources for the public services. Not at all, argues the chancellor: big savings will release resources from administration and back-office support functions into "front line" services.

The well-prepared Mr Brown had a document to hand to prove that this would be possible. According to a report from Sir Peter Gershon, former head of the Office of Government Commerce (OGC), these efficiency gains will amount to £21.5 billion a year by 2007-08—worth 6% of departmental budgets. Over £13 billion of the gains will release cash that can be spent on front-line services; the rest will enable the public sector to do more with its resources.

So how is all this money to be saved? By axeing jobs, partly. There will be a gross loss of 84,000 posts in the civil service; and a net one after redeployment of 71,000, more than reversing its expansion in the past few years. Further savings will come from relocating 10,000 civil-service posts out of London and the south-east into cheaper regions by 2007-08, and an additional 10,000 by 2010. There will be a squeeze on administrative costs. And buying stuff for government centrally and in greater bulk will also generate economies worth £6 billion by 2008. Investments in information technology will make staff more productive.

Sir Peter's jargon-filled report—replete with terms like "back office change agents" and "generic reform maps"—is long on ambition but surprisingly short on important details. It specifies the various ways—such as manpower cuts—through which savings will be made, but doesn't set out how much they will contribute to the £21.5 billion total.

Some large claims for potential savings are couched in unconvincingly vague terms. For example, the education department, whose target is for over £4 billion of annual savings by 2007-08, will "enable front-line professionals in schools, colleges and higher-education institutions to use their time more productively to generate around 30% of the total efficiency gains, enabling institutions to achieve more with their resources." Similarly, the health department, whose target is for £6.5 billion of economies by 2007-08, expects "up to half" of these to come from better use of staff time—a proportion that sounds as though it was plucked out of the air.

David Heald, professor of financial management at Sheffield University Management School, doubts that savings on the scale envisaged can be achieved so swiftly: "the timescale is implausible." And he also points out that centralised procurement methods and manpower targets will undermine the decentralisation of power that the government now believes is necessary to deliver public services more efficiently.

Anyway, can centralised purchasing really deliver big economies? The OGC was set up to improve procurement and it has already made some savings. But specialist purchasing does not necessarily work. For example, departments can buy services like IT and management consultancy through electronic catalogues run by the OGC. However, civil servants say its prices are not necessarily the lowest and that better value can sometimes be obtained from smaller suppliers, according to a report by the National Audit Office.

Nor will it be easy to cut civil-service numbers. The IFS points out that Treasury plans for civil-service numbers have been exceeded for five years running. It estimates that if plans published two years ago had been achieved, there would already be 45,000 fewer civil servants than there are now. Treasury plans for administrative savings have also been a triumph of hope over experience (see chart).

The scale and the timing of the efficiency gains may be questionable. Measuring how the government has performed against these targets will doubtless be fudgeable. But the economy drive has a larger political purpose for Mr Brown. It demonstrates his commitment to value for money in the run-up to the election, showing that he is just as determined as the Conservative Party to cut waste.

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Aid

Changed by Short, not shortchanged

Jul 15th 2004
From The Economist print edition

Aid is getting a bigger rise than any other ministry

AP

Gordon cares

THE Department for International Development (DFID), which administers the overseas aid budget, owes a lot to a political gaffe. Clare Short, its most noteworthy recent minister, was handed the portfolio shortly before Labour came to power because she was too dangerously outspoken to be trusted with the transport brief she had been shadowing.

The move may have been intended as a demotion, but someone forgot to tell Ms Short. She kept her cabinet rank and, more importantly, a close relationship with Gordon Brown, the chancellor of the exchequer. And her willingness to speak unvarnished truths won her admirers in the development world, where polite euphemisms abound.

But DFID has been without Ms Short since she resigned last year in the aftermath of the Iraq war. Her replacement, Baroness Amos, was in the job for just a few months before moving on to lead the House of Lords, and DFID's current boss, Hilary Benn, has been in Parliament for just five years. When DFID lost Ms Short, did it also lose its clout?

Not if Mr Brown's latest spending review is anything to go by. The chancellor, whose campaign for debt forgiveness for poor nations is testament to his commitment to developing countries, will raise DFID's annual budget from just under £3.8 billion ($7 billion) in 2004-05 to more than £5.3 billion by 2007-08. This represents a rise of 9.2% a year in real terms—more than any other government department. Only the decision to move almost a hundred DFID jobs out of London might have clouded the department's spirits. Ready to serve in East Timor or East Africa, fewer DFID recruits will have steeled themselves for a move to East Kilbride.

Nine other countries spend more on aid than Britain as a proportion of their GDP. (Norway, Denmark and the Netherlands are top; the new money will put Britain seventh.) But Britain comes fifth among the countries who David Roodman, of the Washington-based Centre for Global Development, says spend their money best (Denmark, Switzerland, Sweden and Italy—yes—rank just above it).

DFID is quite choosy about which poor governments it lends to. But when it has picked what it sees as a winner, it stands back, letting the government govern, without too many intrusive conditions or requests for thank-you notes (otherwise known as progress reports). In some countries, such as Uganda, Tanzania and Mozambique, as much as half of the money DFID provides is not earmarked for any particular scheme or project at all. It is simply added to the nation's budget, on the sole condition that the government place a high priority on spending likely to benefit the poor.

There are obvious risks to DFID's hands-off approach. A report by the National Audit Office, released last month, complained that DFID could not isolate how much money it was spending on dealing with AIDS, or whether that money was doing any good.

But DFID is making a long-term bet that by making governments account for, manage and spend aid themselves, the money will improve the very institutions it passes through. An AIDS-specific project managed by an NGO might deliver more immediate, more measurable results. But if all such responsibilities are lifted from the state, why should states ever act responsibly? And why should their

citizens ever expect anything more from them?

In her resignation speech last year, Ms Short lamented New Labour's “control freak style”, the “endless new initiatives, layers of bureaucratic accountability and diktats from the centre” that her department and others had to put up with. As a donor, DFID is granting many poor-country governments a degree of latitude that it could only dream of getting from its own paymaster in Number 11.

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Titles

Honour killings

Jul 15th 2004
From The Economist print edition

A ridiculous, outdated system that cannot be improved upon

FEW things that governments do contribute directly to the sum of human happiness, and none are so endearingly daft as the twice-yearly doling out of titles like Dame Commander of the Order of the Bath and Knight Grand Cross of the Order of St Michael and St George. So it was rather churlish for a committee of MPs to propose, this week, that such anachronisms be rationalised out of existence. Even the awards that are allowed to remain should, the committee suggested, be demilitarised and turned into bland honours like the Companion of the Order of British Excellence. What possible reasons could these spoilsports have?

The parliamentary committee has three criticisms of the present arrangements. The honours system, it says, is anachronistic, harking back to an imperial, class-ridden world. It is unfair, in that senior civil servants and diplomats monopolise the wackiest (hence, most treasured) titles. Finally, it is corrupt: public officials tend to give honours to one another, while prime ministers use them to reward political donors and assorted bowers and scrapers.

These criticisms are entirely accurate. But they do not add up to an argument for reforming the system, as the committee claims. On the contrary, advocates of social justice and political reform should argue for the preservation of the system in exactly its current form—or, if possible, rendering it more complex and irrelevant.

A quick glance around the globe suggests that fancy decorations are virtually universal. Honours systems, even bizarre and anachronistic ones, are what anthropologists call “functional”, meaning that they are essential to the smooth running of regimes both conservative and progressive. Guy Stair Sainty, who is editing a new volume of “Burke's Peerage and Gentry”, says that revolutionary regimes tend to abolish honours systems and then, quite swiftly, create equally complicated and hierarchical ones. In the Portuguese republic, the old awards were simply reinstated. Those nations that resist the temptation (Ireland and Sweden are the only examples in Europe) tend to find prominent citizens such as “Sir” Bob Geldof racking up honours from overseas.

Silly titles (and the most coveted ones can be very silly—witness Denmark's Order of the Elephant, or Spain's Golden Fleece) are not objective rewards for merit. But that does not matter, since merit is already rewarded through a device known as pay, as well as through things like Nobel prizes. What decorations do is encourage people in select professions to work for less than they might otherwise demand. This is useful: if civil servants and military men could no longer aspire to bits of enamel and ribbon, they might ask for money, which would be quite awkward for the taxpayer.

As for the charge that honours are doled out to donors, this should surely be encouraged. As David Lloyd George, a Liberal prime minister, pointed out nearly a century ago, it may be the least corrupt way for political parties to raise cash. Certainly, handing out medals and extra letters is preferable to handing out tax breaks and government contracts.

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Royal folly

Small minded

Jul 15th 2004
From The Economist print edition

Prince Charles puts his big foot in tiny matters

Get article background

LAST weekend, readers of the *Independent on Sunday* were treated to an article warning them over the risks posed by the science of nanotechnology. Authors of such pieces rarely find their words echoing around the globe; but this one did, because it was none other than Prince Charles.

Before last Sunday, only 30% of people in Britain recognised the term nanotechnology. More probably do now. Prince Charles has given them, and everybody else, something new to worry about.

Why is the prince agitating about a broad area of study where the common thread is things that are a billionth of a metre in size? Remove the “nano” prefix and you probably get to the heart of his concerns: technology. Or rather, what he termed in his article the “so called ‘technological advances' of recent years”.

Over the years, Charles has expressed concerns over genetically modified food, and promoted alternative medicine and organic food (which, fortuitously, he also produces under his Duchy brand). He provoked controversy recently when he suggested that a cancer patient was cured by a regimen of vegetable juice and coffee enemas.

Whether the royal brow furrows in response to technological innovations or contemporary architecture, the prince's theme appears to be a fear of modernity. Innovation has, of course, ensured a longer and less painful life for the prince as well as to the commoners. But progress has probably benefited the peasants more than it has the aristocracy. And change is, on balance, hazardous for the next incumbent of an office built on mystical tradition and continuity.

Prince Charles's adherence to traditional ways is understandable as a self-preservation mechanism, and has served him well when it comes to making biscuits. It does not, however, make him a suitable commentator on some of the more innovative things his subjects get up to.

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Nurseries and thugs

The perils of roistering

Jul 15th 2004
From The Economist print edition

Psychology and economics pull the government in opposite directions

> Oh, Progeny playing by itself
> Is a lonely fascinating elf,
> But progeny in roistering batches
> Would drive St Francis from here to Natchez

ENOUGH researchers now agree with Ogden Nash, at least as far as the effects on babies of being cared for in large groups go, to force a re-think on how the state provides its share of child-care. A new plan is being discussed to extend entitlement to paid maternity leave, which currently stands at 26 weeks (the first six with 90% of a mother's normal salary paid, the remaining 20 at £100 a week), to one year.

There has been no official announcement yet, but the education department's new five-year plan did talk about providing “more opportunities and support for parents to stay at home with their children if they want to”. The government is now thinking of making a clear promise on this in its election manifesto.

This is odd, given that the government has also been encouraging single mothers to go from the maternity ward to the job centre as fast as possible. Of lone parents (mostly mothers), 53% are now working. The government has set itself a target of upping this to 70% by 2010. So why offer incentives to mothers to stay at home?

Since the mid-1970s, studies have claimed that nurseries can harm a baby's development, but there was enough evidence pointing the other way for the jury to be hung. Recently, two large studies—one American study of over 1,000 children and a British study of over 3,000—have given a clearer idea of who is at risk of what, and proved that some concerns at least are well founded.

The British study identified the group at risk as children who received a high level of care (over 25 hours per week) in large groups during the first two years of their lives. According to Edward Melhuish of Birkbeck College in London, who advises the government on child-care, about 10% of children fall into this category. They were more likely to show signs of antisocial behaviour at the ages of three and five. Long-standing concerns about the effects of mothers going to work have largely been quashed by findings that the same problems do not occur among children cared for by family members. Child-minders come out well too.

The problem appears first in language development. Babies need to be talked to and looked after by someone who knows them well, can read their gurgles and wails and respond appropriately. This is harder in large groups and where staff change frequently. Later on, the same children can become disruptive and aggressive.

One solution is to use child-minders, who can give babies more individual attention. But a drop in demand for their services, plus an off-putting requirement to be inspected by Ofsted's Early Years Directorate, has contributed to a 24% drop in the availability of child-minders since 1997. The National Childminding Association reckons that part of this decline is also down to an unintended consequence of the government spending £14 billion on services for young children since 1998: child-minders have suddenly found there are lots of jobs in nurseries.

Extending entitlement to maternity leave would, according to Mr Melhuish, largely solve the problem. Sweden had lots of group care for babies in the 1980s. Since the introduction of extensive parental leave this has shrivelled. So parents will probably go for it. Convincing the chancellor could be harder.

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Metrication

Measure for measure

Jul 15th 2004
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Inches and ounces are confusing but popular. The mess is unsustainable

WEIGHTS and measures in Britain are an arcane muddle that confirm the country's reputation for dottiness and nostalgia. Packaged sausages sell by the pound, loose ones by the kilo. Fresh raspberries are metric; strawberries usually aren't. It is illegal to sell draught beer by the litre, or petrol by the gallon.

The dithering dates back at least to 1862. Since then, inertia and hostile public opinion have stymied politicians' plans to dump the ounce and inch for tidy decimalities. Officialdom, industry and the education system are now mostly metric; shopping mostly isn't.

All of which is inefficient and confusing. Comparing prices is hard: is a car advertised as drinking 10 litres per 100 km thirstier than one that does 30 miles per gallon? Last week, metrophiles launched a campaign for a final transition.

They dismiss their opponents' nostalgic patriotism, pointing out that Daniel Fahrenheit, who developed the temperature scale beloved by British traditionalists, was from—horrors—Germany. The metric system may have been a French invention, but it's international now, not foreign. Six metric units—the watt, kelvin, farad, newton, joule and gray—are named after British scientists. No other country boasts so many. And as for history: Magna Carta, no less, said there should be only “one measure”.

That's all true. But old-fashioned measures have their virtues, and vocal defenders. Even children born years after the school system went metric give their height in feet and inches; new babies are announced in pounds and ounces. Greengrocers in particular have been fighting hard to keep their (technically illegal) old-fashioned scales. They just want to sell bananas and apples the way the public likes, they argue. The handful of “Metric Martyrs”—traders that have faced prosecution—have become heroes in some eyes for their struggle against that embodiment of evil: meddling, foreign-inspired officialdom.

So what to do? Satisfying the preferences of the anti-metric lot means muddle for everyone else. The passage of time doesn't seem to be solving the problem. Robin Paice of the UK Metric Association says that children grow up in an imperial “ambient culture”. In theory, Britain could return to furlongs, acres and scruples. But not in practice.

So retreat is impossible, and the current impasse costly. The solution, Mr Paice's group argues, is to follow other ex-imperial countries and ban all labelling in non-metric measures. To persuade the government to adopt such an unpopular cause, the push for metrication will have to be hefty—whether that pressure is measured in easy-to-understand hectopascals, or fuddy-duddy pounds per square inch.

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Race in Oldham

Separate tribes

Jul 15th 2004 | OLDHAM
From The Economist print edition

Some things have changed since the riots in Oldham. Some haven't

Get article background

THREE years ago, three nights of rioting between Asians and whites tore Oldham apart. In the aftermath, locals tried to work out what had gone wrong. One of the Asians' main complaints was that racism excluded them from jobs. While 14% of the town's population comes from an ethnic minority, only 2.6% of Oldham Council employees and only 5% of the workers of First Group, a big bus firm, were Asian. Hardly surprising, then, that the unemployment claimant count amongst the town's whites was 4.8%, but 15.3% amongst the ethnic minorities.

Some local employers examined their recruitment practices and found that jobs were handed out largely on the basis of academic qualifications. Since Asians do relatively badly at school, they were also getting fewer jobs. So the employers changed their recruitment practices to emphasise practical skills. Oldham Council now says 5.7% of its workers are Asian and First Group says 20% are.

Asians are doing better at school, too, which should improve their employment prospects further. The proportion of Pakistani children getting five A*-C grades in GCSE exams is up from 25% in 2001 to 34% now, and for Bangladeshi children this pass rate has shot up from 30% to 45%, slightly ahead of white children's pass rate. But as John Tummon, director of the Oldham Race Relations Partnership, points out, the white children's 44% pass rate is hardly a good benchmark—it is well below the English pass rate of 53%.

But if things are looking up in employment and education, the fundamental divide in Oldham persists. There is hardly any social mixing. Most of Oldham's Asians are Muslim and don't drink alcohol, so don't go into pubs. Invisible barriers keep them apart: Mr Tummon says the local snooker hall is occupied by Asians during the day and by white youths at night.

“You don't go into the town centre at night, not even in a car. You'd get battered,” says Ajawad Hussain, one of a group of youths hanging around shops in Glodwick, a mainly Asian area. “This area has got better, the police take crime here seriously now,” says Imran Khan, who runs a car sales business. But he complains that because the police see him driving different cars, he gets stopped and questioned frequently. “The police have a bad attitude,” he says. His complaints dry up though when Irfan Jaffri, an Asian community policeman, wheels up on his bicycle.

Mr Jaffri, whose job was introduced after the riots, listens to complaints that the youths are being hassled by police for hanging out at the shops. Asian shopkeepers, he explains, have been complaining that the youths are upsetting female shoppers. The youths nod understandingly, but resume a tirade of complaints about white racism in Oldham—taxis being attacked with bricks, jobs and promotion being refused—after he moves off. “Asians are only getting jobs on buses because the whites don't want them now,” says Mr Khan.

In a pub a mile away in Hathershaw, a mainly white area, a dozen men refuse to make eye contact or give their names when asked about race relations in Oldham. One man eventually explodes: “I don't like Asians. Ask in any pub—put your hand up if you like Asians, you won't get one.” After he has stormed off, another man—who did put up his hand—says current local rumours are that Asians are getting 12 free driving lessons, and £40,000 discounts on £160,000 new five-bedroomed private houses. “It's not true, just urban myths,” he says.

Such myths fed the riots. Since then the council has given up spending on particular areas for fear of

fuelling these resentments. But, in a town in which the two sides of the racial divide still do not speak, suspicions remain.

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Gambling in the Dome

Put it all on red

Jul 15th 2004
From The Economist print edition

A big loser hopes for some luck

Reuters

CLOSED since the end of 2000, the Millennium Dome has since sat largely idle, an embarrassment the government would prefer to forget about. But a revamp of Britain's gambling business may give it a role.

At the moment, British gambling laws are an idiosyncratic hodge-podge of laissez-faire and bossy regulation. Bookies, for example, have relatively free rein and sports betting is big business. But casinos can only be built in carefully chosen urban areas and punters have to sign up as members 24 hours before they play. The government's new gambling bill, currently percolating through Parliament, aims to change much of this.

It was with the new legislation in mind that Kerzner International proposed this week to use the Dome to house a new £350m super-casino and hotel, as part of a £4 billion redevelopment project for the area. Kerzner is most famous for its Sun City resort in South Africa, built in the apartheid era in one of the tribal homelands where locals could escape the puritans at home. Other gaming and entertainment companies have been dreaming about the potential of a deregulated British market since the government's proposals were announced last year.

The bill may not make it through Parliament. But a slot-machine hall would make a fitting end for the Dome. Without £628m from the National Lottery, Britain's biggest gambling enterprise, it would never have been built in the first place.

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Bagehot

All for one, one for all

Jul 15th 2004
From The Economist print edition

Lord Butler has let Tony Blair off lightly, which will annoy a lot of people

Get article background

WHEN Tony Blair is rattled or embarrassed, he resorts to jeering in a rather horrid, adolescent way. The prime minister was at his least attractive in replying to Michael Howard following his statement on Lord Butler's report. Sarcastically reminding Mr Howard of his continued support for the war (as if this disqualified him from making any criticism), all Mr Blair offered was bluster. Seriousness, even a hint of contrition, would have served both him and the moment better.

The Tory leader had managed to get under the prime minister's skin by contrasting Mr Blair's own confidence about Iraq's WMD in the foreword to the September 2002 dossier with the supposedly more cautious assessment of the Joint Intelligence Committee (JIC). Mr Howard wanted to know “how their qualified judgment became his unqualified certainties”. Whether or not Mr Blair had acted in good faith, as Lord Butler agreed he had, was neither here nor there, according to Mr Howard. He was still guilty of misleading the public about the nature and imminence of the Iraqi threat.

Mr Howard was going a good deal further than the more nuanced judgment of the report. In fact, Lord Butler has explicitly cleared the government of any deliberate attempt to mislead. But, like the clever lawyer he is, Mr Howard had unerringly highlighted Lord Butler's sternest censure of Mr Blair.

“In translating material from JIC assessments into the dossier, warnings were lost about the limited intelligence base on which some aspects of these assessments were being made,” says the report. “Our view, having reviewed all of the material, is that judgments in the dossier went to (although not beyond) the outer limits of the intelligence available. The Prime Minister's description, in his statement to the House of Commons on the day of publication of the dossier, of the picture painted by the intelligence services in the dossier as ‘extensive, detailed and authoritative' may have reinforced this impression.”

From an old-school mandarin like Lord Butler, that is a sharp rebuke, but far from fatal for Mr Blair. Aside from some barbed comments about his informal style of governing, that is the worst the report has to say of the prime minister personally.

Like all whose professional lives have been spent in great institutions, Lord Butler is reluctant to pick on people. He blames nobody in particular for either the intelligence failures or the misplaced certainties of the dossier: the responsibility for what went wrong, he maintains, was collective. His refusal to hold anyone (above all, Mr Blair) directly to account will inevitably anger some and puzzle many. While a lot of people were involved in the errors of judgment he recounts, some must have been guiltier than others. In particular, who should take the blame for removing the essential caveats that undermined the integrity of the dossier? Lord Butler is silent.

Lord Butler does not go as far as Lord Hutton in giving everyone (apart from the BBC) the benefit of the doubt, but he is good at finding excuses. He is merciless, for instance, about the dubious reliability of the sources the intelligence service was forced to rely on in Iraq. But by pointing out that JIC reports do not express degrees of confidence in the judgments given or include dissenting hypotheses, he lets Mr Blair off the hook over including in the dossier the erroneous claim that Iraq had WMD which could be launched within 45 minutes. Not surprisingly, the familiar reasons for the faulty intelligence on WMD are not really anyone's fault: it was difficult to recruit agents in Iraq after the weapons inspectors left in 1998; it was reasonable to think, given his record and behaviour, that Saddam Hussein was up to no good; everybody was determined, after September 11th and the first Gulf war, not to err on the side of optimism.

Lord Butler describes the pressure on MI6's spies to come up with better and stronger material in the months before the war. He also shows how the JIC assessments were progressively hardened as the expectation of war increased. But he does not provide a clear answer to the central question of whether intelligence was driving policy or the other way round. The truth is almost certainly a complex mixture of the two, but a better understanding of what happened would help avoid similar dangers in the future.

Lord Butler doesn't think—as the Senate Intelligence Committee does of the CIA—that Britain's intelligence services are broken. He praises their work in dealing with threats from other “countries of concern” and recommends minor but sensible changes to avoid repeating mistakes that were made over Iraq. In order to avoid the risk of blurring advocacy with intelligence assessment, future dossiers—God forbid that there should ever be any—ought clearly to be the work of the government and not the JIC. Future JIC chairmen should be in their last job, to ensure that they are “beyond influence”. The implicit criticism of John Scarlett, the JIC chairman at the centre of the dossier controversy, could not be plainer. Yet, astonishingly, Lord Butler maintains he should still take up his new post as head of M16.

Passion spent

Better still for Mr Blair, while Lord Butler carefully avoids commenting on the political decision to go to war, he goes out of his way to provide a notably sympathetic context for it. Helpfully, he concludes that Iraq had the “strategic intention” of cranking up its weapons programmes the minute the pressure on it from inspections and sanctions was lifted.

Does this mean that Mr Blair may finally have put Iraq behind him? Hardly. Most people still correctly believe that, whether wittingly or unwittingly, with the best of intentions or the worst, the government exaggerated the case for war. Some are still very angry, but more are now very bored. Lord Butler's excruciatingly careful report will change not a single mind.

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The health of nations

Jul 15th 2004
From The Economist print edition

Health care consumes a large and growing chunk of rich countries' income, but does it provide value for money? Paul Wallace investigates

HIS financial empire made him the equal of kings, his fortune was the envy of the merely rich. But in the summer of 1836, Nathan Rothschild was dying of an abscess leading to blood-poisoning, and all his wealth was to no avail.Today, a dose of antibiotics, costing a few coins, would have saved the 59-year-old banker. What would he have been willing to pay for that prescription?

To the seriously sick, effective medical care is priceless. But not everyone who goes to the doctor is gravely ill, nor is all health care effective. Yet someone has to foot the bill, whether or not the health care works or is really needed. Individuals' demand for medical care is potentially boundless, but the collective systems that fund most health care must impose limits. That contradiction is a growing problem for rich countries as costs spiral upwards.

In America, publicly financed health care goes mainly to the old and the poor; most American workers and their families are insured privately through their employers. But after a welcome period of restraint during much of the 1990s, the cost of these employer-funded benefits has been rising at double-digit rates in the past few years. Alain Enthoven, a health economist at Stanford University who has pioneered cost-control strategies, paints a scenario in which a continuing cost explosion opens the door for a government takeover of employer-financed health care after the 2008 presidential election.

That would move America's mixed-funding arrangements—which leave 44m people without health-care cover—closer to the Canadian model, in which taxes finance the free use of hospitals and doctors for all. Yet even Canadians have been losing faith in a system that was once a source of national pride. In 1988, some 60% of Canadians thought their health system worked well, but by 2002 only 20% did, and a big majority thought that a fundamental shake-up was needed. Health care was the biggest issue in the recent general election.

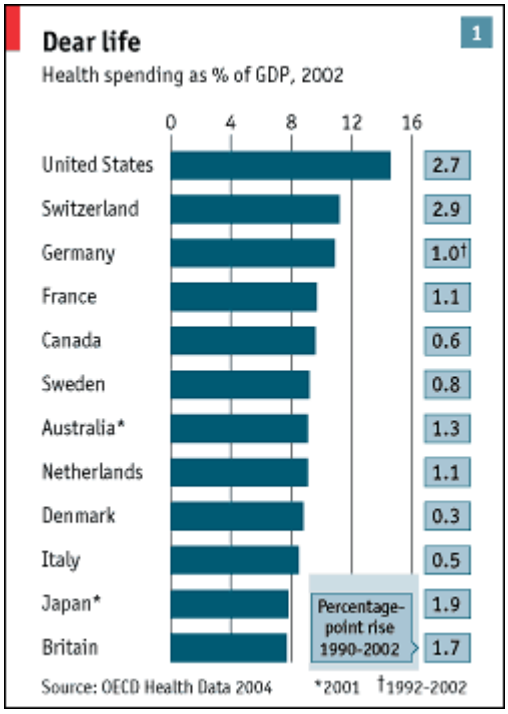
Several European countries finance health care mainly through compulsory contributions from employers and employees. This social-insurance model, pioneered in Germany by Otto von Bismarck in 1883, has proved vulnerable to a combination of rising health-care costs and a shortfall in contributions resulting from high unemployment. But reforms in Germany and France to try to reduce the deficits have proved unpopular.

Pressures on national budgets are also causing international tensions, particularly over the pricing of pharmaceuticals, which are consuming a growing share of the total health-care bill. Prescription drugs are generally much more expensive in the United States than in Canada or Europe, where government-dominated health-care systems are able to extract bigger discounts. Tommy Thompson, the American health secretary, says this means his country is shouldering much of the cost of pharmaceutical research, and has asked the Europeans to pay more.

Medical tithe

Already, health-care spending on average swallows up nearly a tenth of GDP in rich countries, and that proportion is rising steadily (see chart 1). Looming ahead are further expenses as the post-war baby-boomers get older and are likely to need more health care. In America, long-term projections by the Congressional Budget Office indicate a steep rise in federal-government spending on health care for the elderly through Medicare. In 2003, this accounted for 2.4% of GDP, but the CBO's central forecast shows it rising to 8.3% by 2050, partly because under new legislation Medicare will have to pick up a sizeable chunk of the cost of prescription drugs for older people from 2006.

Looking on the bright side, there is now much clearer evidence that medical care pays off in healthier and longer lives. That link was once questioned—Mr Rothschild's experience notwithstanding—because international comparisons showed no clear relationship between the resources devoted to medical spending and measures such as life expectancy. But more detailed research into specific conditions such as cardiovascular disease has established that the benefits of medical treatment may handsomely exceed costs. William Nordhaus, an economist at Yale University, has estimated that the welfare gains from higher life expectancy in America in the second half of the 20th century almost matched those from higher consumer spending on things other than health.



Does this, then, provide a licence to cure at almost any price? Hardly. Along with the research establishing the benefits from medical treatment has come other research showing up the waste, inefficiency and poor quality of much health care. Reports published by America's Institute of Medicine have documented a distressingly high rate of medical errors in hospitals, which may cause as many as 98,000 deaths a year—far more than those caused by road accidents. There was “abundant evidence that serious and extensive quality problems exist through American medicine, resulting in harm to many Americans”. The blunt conclusion: “The costs of waste, poor quality and inefficiency are enormous.”

Evidence from other countries suggests that they suffer from similar problems. The medical sector has been slow to invest in information technology, which holds great potential to reduce errors and improve efficiency and quality. Health care is poorly co-ordinated, which is a particular drawback for the growing number of patients with chronic conditions requiring sustained rather than occasional medical care. Effective integration of services provided by primary-care physicians and hospitals is still all too rare.

All this suggests that the system reflects the priorities of providers—doctors and hospitals—rather than consumers, and that there is plenty of scope to push for a better bargain from the huge amount of money now spent on medical care. The central goal for policymakers in the developed world, says the OECD in a recent report, “Towards High-Performing Health Systems”, is to raise efficiency and to get more value for money in medical care.

But the health-care system is resistant to reform. A simple clampdown on expenditure—the usual strategy—contains cost pressures for a while, but they usually resurface as the public clamours for more money to remedy the shortcomings caused by the restraint. Whether cost containment takes the form of budget caps or price controls, it leaves the structure of health care and the underlying power of providers intact. Empowering the consumers of medical care is hard because so much of it is bought indirectly through insurance. Health-care insurers typically respond to increased competition by trying to select the best risks rather than by driving down costs among providers. Getting consumers to pay a bigger share of the cost is likely to make the health-care market work better, but there are limits to the amount of risk that most individuals can shoulder, and to their ability to bargain effectively with doctors and hospitals.

The best hope for successful reform lies in making it easier for health-care insurers and group purchasers to bear down on providers directly. Until now, they have been handicapped by a lack of information about the quality of medical provision. But that is about to change, thanks to a number of important initiatives to set out quality standards and to measure the performance of doctors and hospitals against them.

There is also plenty of scope to introduce more competition into the provision of medical care. In Britain, the government-run National Health Service has awarded contracts for some routine operations (such as hip replacements) to foreign health-care groups. The volume of work will initially be quite small, but the entry of new providers has already administered a salutary shock to a service long shielded from effective competition. Similar innovations are being tried elsewhere. For example, Germany is trying to dismantle the barrier that has largely confined hospitals to providing in-patient care.

This survey will examine the cost pressures in health care, mainly in America and Europe, and the value as well as the waste and inefficiency of much medical spending, drawing on new research. On that evidence, health-care services need to be comprehensively re-engineered. The survey sets out what rich countries are doing to get a better return on the huge sums of money being spent on medical care.

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No reverse gear

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Why costs only ever go up

SOON after Britain's NHS came into being in 1948, Aneurin Bevan, its political founder, predicted that an initial surge of demand would subside as the service caught up with the backlog. A year later he knew better: "I shudder to think of the ceaseless cascade of medicine which is pouring down British throats at the present time." In 1951, he resigned when the Treasury imposed minor health-service charges. Already, costs were three times higher than originally expected.

This episode, when "the first thing that happened was that expenditure took off into the stratosphere and had to be sat upon very firmly", was long etched into the collective memory of senior health and finance officials, says Jeremy Hurst, a health economist at the OECD. For many years, Britain imposed strict controls that helped keep its costs down rather more successfully than those in other rich countries. Yet public discontent with an increasingly rickety service has prompted a massive boost to resources under today's Labour government. Spending on the NHS is scheduled to rise by over 7% a year in real terms until 2007-08. By then, total health expenditure in Britain will have vaulted to 9.4% of GDP, compared with 6.9% in 1998, the year before the spending spree started.

As a general rule, medical spending in rich countries tends to rise faster than national output. For example, its average share of GDP in a group of 18 developed economies rose from 5.2% in 1970 to 8.9% in 2001. Already, three countries—America, Switzerland and Germany—spent more than 10% of GDP on health care in 2002. In America, expenditure has now reached almost 15% of GDP, by far the highest share anywhere, and the gap between it and other countries has widened over the past three decades. But this does not necessarily reflect American profligacy: it can also be caused by higher GDP growth in other countries, as Ireland's recent experience illustrates. Health spending per person there rose by 6.8% a year between 1990 and 2000, compared with 3.0% in America. However, Ireland's economy grew so fast that the country's health spending as a share of GDP increased only minimally, whereas in America it rose by more than one percentage point during that period.

Over the longer term, as Paul Ginsburg of the Centre for Studying Health System Change in Washington, DC, points out, the increase in health-care spending per person in other industrialised countries has been remarkably similar to America's. Since 1970, the average real growth in rich countries outside America has been 4.0% a year, compared with 4.4% in America.

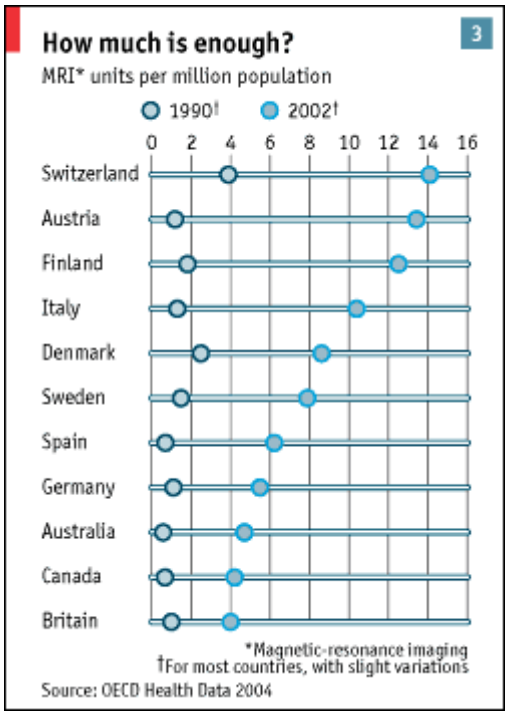
This suggests a common cause. A survey conducted by Victor Fuchs of Stanford University in 1995 showed that most health economists point the finger at advances in medical technology. Scientific research establishes the basis for expensive new medical procedures (eg, transplants), products (eg, magnetic-resonance imaging scanners) and drugs. The Tufts Centre for the Study of Drug Development calculates that, taking into account failed products, it now costs $900m to develop a new prescription drug. America usually adopts new technologies first, but they soon spread to other countries.

Over time, the cost of medical technologies declines, especially when proper account is taken of quality improvements. Expensive drugs protected by patent are replaced by cheap generics. Surgical procedures and medical devices fall in price, so the cost per patient drops. But this is more than offset by the rise in the demand for such treatments, which pushes up expenditure per person.

In addition, the health-care sector is labour-intensive, so that the more it does, the more people it needs, many of whom are highly paid. In America, pay and other benefits account for over 60% of hospital running expenses. Many medical services are hard to standardise, so there is less scope to drive down costs through automation. William Baumol, an economist at New York University, has characterised health care as “a handicraft industry” afflicted by the chronic “cost disease of personal services”.

Yet these explanations are not wholly convincing. Technology may be raising costs, but only because the market is ready to pay for expensive innovations. New medical technologies could in principle be directed towards cost-saving innovation. And why has the sector been so sluggish in adopting information technology, despite its potential for raising efficiency?

National health systems in different countries appear diverse, but all of them are forms of insurance against unexpected medical bills. This means that the bulk of health care is paid for by third parties, whether private insurers or governments. Medical technologies are developed for and used in a market that is much less sensitive to budget constraints than individual consumers would be. “It's the interaction of health insurance with innovation that's driving the system,” says Dana Goldman, a health economist at the RAND think-tank in Los Angeles.



In this third-party-payer market, doctors play an ambivalent role: they both supply medical care and demand it on behalf of their patients. This can create “supplier-induced demand”. Victor Fuchs draws an analogy with the car market. Suppose, he says, car dealers had to certify whether you needed a new car, and you were not paying for it directly out of your own pocket: there would be a lot more luxury cars around.

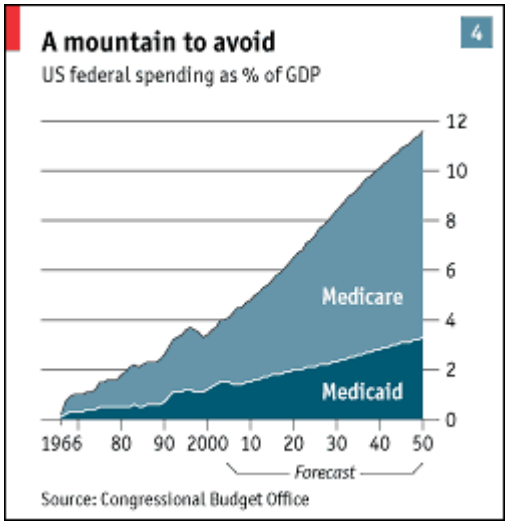
“The idea that we have a classic competitive market just doesn't apply to health care,” says Alan Garber, director of the Centre for Health Policy at Stanford University. In some sectors, he points out, there are monopolies, such as drugs under patent; in others there are oligopolies, such as hospitals, which face weak competition because most medical care is demanded and provided locally.

The recent resurgence in medical costs demonstrates the resilience of producer power in the health-care market. In America, hospital spending growth, which was held down in the mid- to late 1990s, has rebounded. Hospitals blame cost pressures from labour shortages and new regulatory requirements; others say it reflects their market power, which has been aided by a wave of mergers. “There was enough consolidation they could turn round and thumb their noses at the health purchasers,” says Helen Darling, president of the National Business Group on Health. In the pharmaceutical sector, nominal spending on prescription drugs has been rising by over 15% a year. In rich countries, growth in spending on pharmaceuticals has recently been considerably faster than that of overall health-care spending.

Without reforms to change the structure of health-care markets, expenditure looks set to carry on rising. And before long costs will get another upward nudge as the number of older people in rich countries rises. From about 2010, the big baby-boom generation born after the war will reach retirement. This will push up the proportion of Americans over 65 from 12% in 2000 to 20% by 2030. In many other developed countries the share will be even higher, of which more below.

The link between age and health spending is less straightforward than it might seem. It is true that older people are heavy consumers of health care: spending per person on the over-65s is three to four times higher than on younger adults. However, much of this higher expenditure is incurred in the last two years of life. This is also true of people who die younger, which suggests that as people live longer, costs will be deferred rather than raised. RAND's forecasting model of health-care costs suggests that increasing longevity is not in itself a big problem. “If you keep people alive, in general you keep them alive in a relatively healthy state and it doesn't cost a lot,” says Mr Goldman.

The gimme generation



On the other hand, baby-boomers are likely to be more expensive customers than today's older generation. “They are much more voracious consumers of health care,” says Ms Darling. “They have a different attitude, they want to be able to run races when they're 90. It's a generation that says I can't run, fix my knee,” says Martha Marsh, the chief executive of Stanford Hospital.

Official projections generally assume that current age-related patterns of health spending will continue in the future, so they capture neither of these two potentially offsetting effects. What they do capture is the impact on health costs from the sheer number of ageing baby-boomers, which the OECD reckons will add two percentage points of GDP on average to health-care spending in developed economies by 2050. This projection assumes that health-care spending per elderly person rises broadly in line with living standards.

That, however, is not what has happened in the past. Since 1970, America's Medicare costs per member have risen by three percentage points a year faster than GDP per person. The CBO assumes that this margin will narrow to one percentage point, but still forecasts that Medicare's spending as a share of GDP will more than treble by 2050.

The forecast allows for the effect of the new prescription-drug benefit for the elderly, which starts in 2006. That benefit has an unusual design: the patient pays the first $250 in a year, Medicare most of the next $2,000, the patient the subsequent $2,850, and then Medicare picks up almost all additional costs. Kent Smetters of the Wharton School, who has drawn attention to the long-term imbalance in Medicare's finances, says: “We've created this big doughnut hole. Do we really think it won't be filled? If it is, Medicare gets a whole lot more expensive again.”

Add in federal-government spending on Medicaid, a joint programme run with the states, which directs money to low-income groups, including the elderly, and total federal budget spending on health care will soar to 11.5% of GDP by 2050, according to the CBO's central forecast. That would require hefty tax rises.

In European countries, increases in health-care spending have recently helped to move national budgets from surplus into deficit. In Britain, the big increases earmarked for health have left little room for many other public spending programmes. Population ageing will be especially marked in Europe: the ratio of people of working age to those over 65 will halve, from four to one now to two to one by 2050. With fewer workers to generate tax revenues, further rises in health spending could destabilise the public finances.

Such forecasts explain why health budgets have become a big worry for policymakers. When the finance ministers of the G7 leading industrialised countries meet, they usually talk about things like currency markets or economic instability. But when they got together in May this year, they also discussed health spending.

It is easy to see why endlessly rising health costs should make finance ministers shudder. But if higher health spending results in healthier and longer lives, is that not something to celebrate?

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Anatomy lesson

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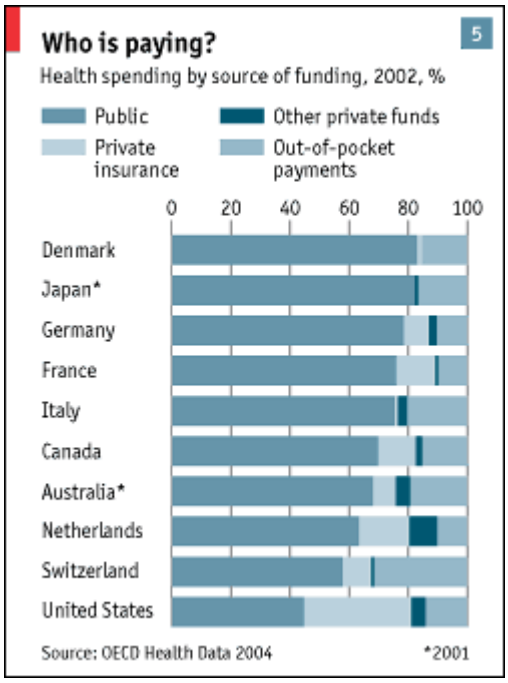
How health-care services are financed



RICH countries use a variety of ways to pay for health care, but in almost all of them the main source of money is the public sector (see chart 5). On average across the OECD countries, it accounted for 72% of health expenditure in 2001. The lowest share was in America, where public money represented only 45% of total health spending.

There are three main ways of funding health care: mostly through taxation, as in Canada, Britain and Sweden; mainly from compulsory contributions made by employers and workers, as in Germany, France and the Netherlands; and with a large contribution from voluntary private insurance, of which America is the only example. This stream of funding is dominated by employers because health-care benefits for employees are exempt from taxes. Allowing for the value of that tax break, the government is estimated to finance nearly 60% of all health spending in America.

Private sources of health-care finance are out-of-pocket payments and insurance. In contrast to America, in most countries private insurance provides additional rather than primary cover. In Canada, it is used to cover things like dental care that are not met by public insurance. In France, it is used to meet co-payments by individuals that top up the main payments from the public programme. In Britain, supplementary private insurance is often used to jump long queues for operations under the National Health Service.

Although health care is funded mainly from the public purse, in most countries it is delivered by a mixed economy. Doctors working in the primary sector are usually self-employed or in private practice. The public sector is most heavily involved in running hospitals, and in Britain it also exerts strong control over primary care through its contract with physicians. By contrast, in Germany about half of hospital beds are privately run, though mainly not-for-profit, and in the Netherlands more than 90% of hospitals are private not-for-profit organisations.

Pay structures also vary widely. In America, most doctors are paid on a fee-for-service basis. In France, primary-care physicians are paid that way but doctors in public hospitals draw a salary. In Britain, hospital doctors are salaried and general practitioners are remunerated mainly through a mixture of capitation and performance payments.

In most rich countries both financing and provision are becoming more mixed, says Elizabeth Docteur, a health economist at the OECD. In America the government's share of funding is rising, whereas Germany is trying to get individuals to pay more for their health care. France has broadened its public financing base to include tax revenues as well as social-insurance contributions. The British government, while maintaining its commitment to a publicly funded health service, is now giving greater autonomy to public hospitals and using private providers to do more work for the NHS.

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Money well spent?

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It depends on how you do the sums

DESPITE the prodigious growth in health-care spending over the past 40 years, there have long been nagging doubts over whether it provided value for money. Medical advances such as vaccines and antibiotics against infectious diseases have clearly done much to improve people's health, but these things are relatively cheap. What has all the rest of the spending achieved?

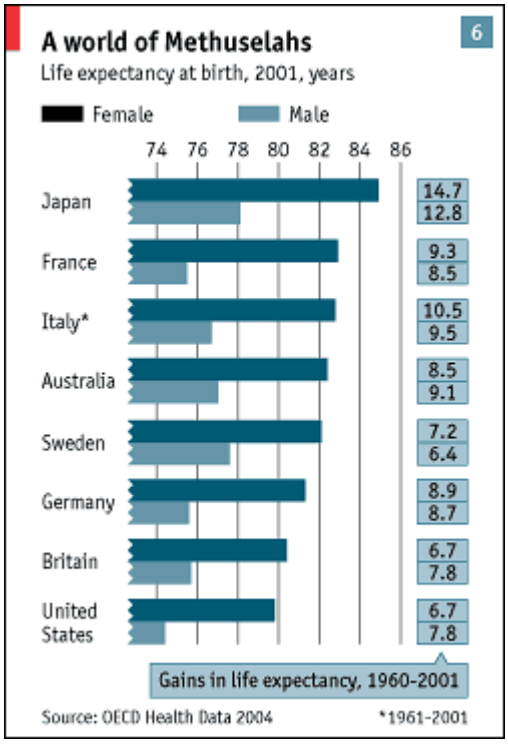
A commonly used gauge of health status is life expectancy. This measure casts doubt on the effectiveness of heavy spending on health care in recent decades on two grounds. First, the biggest increase in life expectancy pre-dated the introduction of national health-care systems. In England and Wales, for example, life expectancy at birth rose by 20 years in the first half of the 20th century, but by only ten years in the second half. The most important reason for the early gain was the conquest of the infectious diseases that were taking such a heavy toll a century ago. But the biggest improvement occurred before the introduction of mass immunisation programmes and antibiotics. It is thought that medical care accounts for only about a fifth of the 20th-century gains in life expectancy in Britain and America. The rest came from improvements in nutrition, sanitation, hygiene and housing.

The second reason to doubt the value of health-care spending emerges from international comparisons. America spends easily the highest proportion of its GDP on medical care, but its people's life expectancy at birth is lower than in many countries with more modest health budgets (see chart 6).

Such comparisons are often used to criticise the American health-care system or to defend stingy medical budgets in other countries. Yet what they really show is that health is a complex matter, with medical care just one contributory factor. Health can be seen as a capital good in which individuals invest not just through spending on medical care but through their own behaviour, for example by cutting out smoking, over-eating and binge-drinking. Living conditions and environmental factors can also affect health.

An influential exponent of this view is Stanford University's Victor Fuchs. In his classic text, “Who Shall Live?”, first published in 1974, he wrote that differences in health levels between America and other developed countries “are not primarily related to

differences in the quantity or quality of medical care. Rather, they are attributable to genetic and environmental factors and to personal behaviour." He suggested that "higher income often seems to do as much harm as good to health, so that differences in diet, smoking, exercise, automobile driving and other manifestations of 'lifestyle' have emerged as the major determinants of health."



Until recently, most health economists were sceptical about the contribution of medical care to general health, says Ted Frech of the University of California, Santa Barbara. A former sceptic himself, he now argues that even allowing for the effect of lifestyles, medical care does make a difference. He is convinced about the value of drugs, especially the cholesterol-lowering statins used to counter cardiovascular disease. His analysis of 18 advanced countries suggests that pill-popping does work: "Countries that consumed more pharmaceuticals saw their populations live longer and suffer less ill health than those that consumed less."

William Schwartz of the University of Southern California School of Medicine stresses that medical care delivers more than longer lives. It pays an extra dividend by improving the quality of people's lives, for example through greater mobility, enhanced vision and pain relief. He argues that the cost of such treatments accounts for a considerable part of the spending gap between America and other countries.

At the same time, the quality of treatments has improved by leaps and bounds. New forms of surgery are less invasive and allow swifter recovery. New drug therapies mean that patients receiving heart transplants now spend only ten days at Stanford Hospital, whereas 20 years ago they often stayed two months or longer, says Ms Marsh. Jack Triplett, an economist at the Brookings Institution, cites cataract surgery as an example: "At one time you had to spend ten days immobilised in intensive care. Now it's done as an outpatient appointment, so not only has quality improved but it takes far less time."

In a recent book, "Your Money or Your Life", David Cutler, an economist at Harvard University, offers some interesting sums on the value of health care. For example, an American aged 45 today will live four-and-a-half years longer than he would have done in 1950 because of a decline in cardiovascular disease. Mr Cutler attributes two-thirds of this increase in life expectancy to better medical care and the remaining third to behavioural changes, such as giving up smoking. Survival rates for low-birth-weight infants have also improved greatly because of medical treatment. These are the two areas where health care has made the biggest difference to mortality in the past 50 years.

What's life worth to you?

People put a high value on living longer: Mr Cutler estimates that an extra year of life is worth $100,000 to an individual. On that basis, he reaches a startling conclusion: that in America "the benefits of medical advances for these two conditions alone are equal to the entire increase in medical costs in the past half-century." This finding appears to overturn the conventional wisdom that the value of medical spending is questionable, and to vindicate the vast sums poured into health care.

One difficulty with this kind of analysis is that it does not compare like with like. Costs are real: they have to be met out of workers' incomes, whether through insurance premiums, cash payments or taxes and social-security contributions. In contrast, the valuation of benefits is notional. True, it is derived from solid evidence, such as the amount of money people are prepared to pay for safety features, eg, car airbags, that could save lives in a crash. But this prompts the question: why do so many people take so little care of themselves even though it may cost little or nothing, whereas once they have become ill medical intervention costs such a lot?

Yet this new research underlines an important point: whatever the doubts about the contribution of medicine for much of the past century, it is now doing much more to push up life expectancy. Ahead lies the prospect of even greater gains as advances in the life sciences are translated into innovative therapies. Potential treatments include targeted techniques to combat cancer and tissue engineering to

replace failing organs. John Potts, former research director of Massachusetts General Hospital, says that further big increases in life expectancy are “within the capacity of the scientific knowledge base and medical delivery system if you didn't have to worry about costs”.

But costs should be less of a worry if the gains in health are so highly valued. Mr Cutler has no difficulty in principle with projections in which health spending as a share of the economy continues to grow to, say, 30%. Such a figure may seem outlandish, but the current share of 15% would itself have seemed absurd in 1960, when America's total health expenditure amounted to only 5% of GDP.

There are two major objections to the idea that health care should absorb an ever rising share of national income. If this arose from private choices subject to the constraints of household budgets, all well and good. But as Peter Zweifel, a health economist at Zurich University, points out, this is a market in which governments intervene on a massive scale. Governments, for their part, have to worry about raising taxes, which may slow economic growth.

Secondly, the overriding objective for policymakers, as Mr Fuchs insists, is to ensure that additional money put into health generates commensurate additional gains. Mr Goldman of RAND puts it this way: “The question is whether medical technologies are effective at the margin. For example, there will be a class of people for whom statins are clearly valuable, but should we put them in the water?” Mr Cutler himself is a fierce critic of many wasteful features of American health care.

These worries are given added weight by a recent accumulation of findings about inefficiency and waste in medical care. Clearly, these problems need to be tackled first before writing a blank cheque for health budgets.

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Wasting disease

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A tale of poor quality and inefficiency

“OUR attempts to deliver today's technologies with today's medical production capabilities are the medical equivalent of manufacturing microprocessors in a vacuum-tube factory. The costs of waste, poor quality and inefficiency are enormous. If the current delivery system is unable to utilise today's technologies effectively, it will be even less able to carry the weight of tomorrow's technologies and an ageing population, raising the spectre of even more variability in quality, more errors, less responsiveness and greater costs associated with waste and poor quality.”

This indictment of America's health-care system comes not from an angry blogger but from the prestigious Institute of Medicine in a landmark report, “Crossing the Quality Chasm”. The result of years of work by a committee of experts, it is scathing about the poor standards and wastefulness that it found.

One manifest sign of poor quality is the number of people who die because of medical errors. In an earlier report, the institute estimated that such errors in American hospitals were responsible for at least 44,000 deaths a year, and perhaps more than twice that. Medication errors alone, such as incorrect dosages, accounted for 7,000 deaths. According to the institute, health care was “a decade or more behind other high-risk industries in its attention to ensuring basic safety”.

Not only can medical errors result in human tragedies, they also waste money because of compensation claims and the additional spending needed to try to put things right. Another kind of waste stems from the inappropriate use of medical procedures on patients for whom the risks outweigh potential benefits. This happens on a worryingly large scale; for example, 14% of bypass surgeries in America have been assessed as inappropriate.

The picture in other countries is much the same. Recent studies in Canada and Denmark have documented a high incidence of medical errors in hospitals. Thomas Schioler of the Danish National Board of Health says that in many countries a large number of patients are injured because of medical treatment and not because of their underlying disease. Over-use of medical procedures is also common. In Sweden and Britain, for example, 10% and 16% respectively of bypass surgeries have been found to be inappropriate.

Yet another form of waste is under-use of appropriate medical care. A report from the National Committee for Quality Assurance, an independent watchdog of American health care, estimated in 2003 that over 57,000 American deaths a year could be attributed to a failure to deliver best-practice care. The NCQA calculated that this failure generated an annual bill of $1.6 billion in avoidable hospital costs.

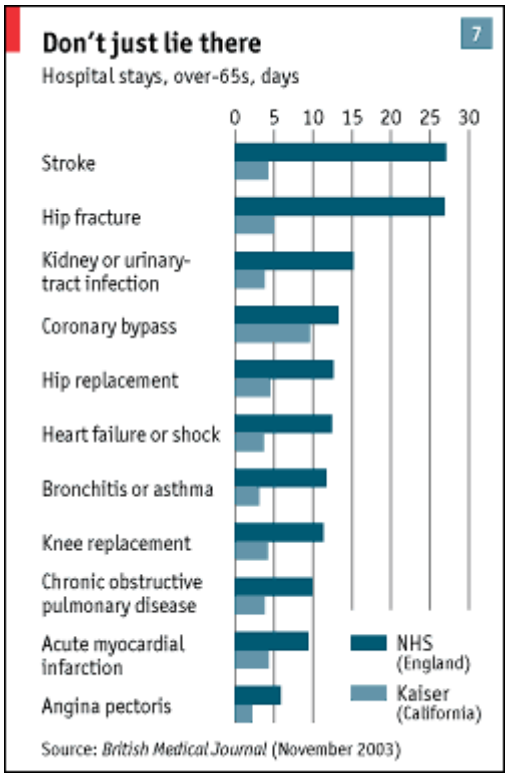
According to a recent survey from the RAND think-tank, American adults receive little more than half the medical care recommended. Reviewing a subsequent comparison of the quality of care in five countries—Australia, Canada, New Zealand, Britain and America—Elizabeth McGlynn, who led the RAND study, recently wrote in *Health Affairs* that other countries were doing no better than America. Ms McGlynn believes that if the RAND survey were repeated in the other four countries, “we would find very similar levels of performance to those found in the United States overall.”

Getting it together

Medical systems are inefficient, too. As the Institute of Medicine's report says: “Surgeons know that operations rarely start on time; doctors and nurses wait ‘on hold’ as they try to track down vital information, and delays and barriers involved in referrals eat up the time and energy of both referring doctors and consulting specialists.” In Britain's NHS, many operating theatres stand idle unnecessarily,

even though there is huge pressure to cut the numbers waiting for operations. Auditors have calculated that operating rooms are used on average 24 hours a week instead of an intended 40.

One of the biggest failings of modern health-care systems is that they so seldom provide integrated medical care. In emergencies, patients head for the local hospital; for minor illnesses they consult their family doctor. But for chronic conditions such as diabetes and cardiovascular diseases, which are becoming increasingly prevalent, they require care and advice both from their primary physician and from the hospital. Effective co-ordination of this care results in better and cheaper treatment, yet too often it does not happen. According to the OECD, “health-care organisations, hospitals and physicians typically operate as separate ‘silos’, acting without the benefit of complete information about the patient's condition, medical history, services provided in other settings, or medications prescribed by other clinicians.”



Inefficiency also stems from poor allocation of resources across different parts of the health-care system. Too much is done in high-cost hospital settings, and too little in lower-cost primary settings. Traditionally, physicians in primary practice have worked as independents from small offices. Given the demands of patients for round-the-clock access and the increasing complexity of medicine, this structure no longer works well. But it has left a legacy of under-capitalised primary care, even though many treatments are now better carried out away from hospitals.

Germany's medical-delivery system has long been organised in a particularly inefficient way. With only a few exceptions, hospitals have been confined to in-patient care, and hospital specialists have not been able to provide their services in cheaper out-patient clinics. This restriction, which dates back to 1931, has created an opportunity for independent specialists, but half of them work on their own rather than in well-capitalised group clinics. This strict separation of care has prevented effective integration of services between primary-care physicians and hospitals—for example, for cancer patients, says Reinhard Busse of Berlin's Technical University. Not before time, reforms have now been launched to get rid of these restrictive practices.

But Germany is only an extreme example of medical-delivery systems organised to serve the interests of doctors rather than patients. One exception to the rule is Kaiser Permanente, a health-maintenance organisation (HMO) that provides care to 8.2m Americans insured with it. Established in 1945, Kaiser has a distinctive model of health care. It owns most of the hospitals and medical facilities that it uses. Its physicians, who are salaried rather than paid on a fee-for-service basis, work together in group practices which they manage themselves. This structure has enabled it to develop a genuinely integrated form of medical care.

Richard Feachem, executive director of the Global Fund to Fight AIDS, Tuberculosis and Malaria, based in Geneva, is impressed: “There is no perfect system in the world, every one has serious flaws and makes serious mistakes which people suffer from, but Kaiser comes closer to an ideal than any system I know.” Shortly before starting his present job, he led a controversial comparison of Kaiser's operations in California and Britain's NHS, which suggested that Kaiser achieved a better performance overall with roughly the same resources per head as the NHS. But how? Mr Feachem puts it down mainly to better integration. “Without question Kaiser has achieved a greater degree of integration than the NHS—integration between prevention and cure, out-patient and in-patient services and between primary-care physicians and hospitals,” he says.

This allows Kaiser to treat patients at the most cost-effective level of care, economising in particular on expensive time in hospital. A subsequent comparison of the two systems, led by Chris Ham, director of the strategy unit at the Department of Health in London, dealt with some of the methodological objections to the original study by looking at acute care for those aged 65 and over. Across a range of 11 common clinical conditions, it found that admission rates were mostly higher in the NHS than in Kaiser. Once admitted, NHS patients spent much longer in hospital than Kaiser patients. The disparity was highest for strokes and hip fractures, where NHS stays were five to six times higher than those in Kaiser hospitals.

Kaiser pays a great deal of attention to the patient's journey through hospital, explains Mr Feachem:

when a patient enters the hospital, staff are already planning his discharge. This strategy has the “full backing of physicians, not just managers, because it is good medicine”. A systematic approach to the patient journey is crucial, because “if you cumulate a small number of delays, you can lose 48 hours”. The patients like it too, he adds, because they feel that staff are on the case.

The NHS is taking a leaf out of Kaiser's book. Managers from several hospitals and primary-care organisations have spent time in California observing its methods, and are now trying to implement them in various parts of Britain. It will not be easy. Replicating the Kaiser model has proved tricky even in America.

Deus ex machina

But there is another, more universally applicable way to achieve better, more integrated medical care. Information technology provides a means to avoid many medication errors: computerised systems, including electronic patient cards, would allow checks on the accuracy of doses and improve patient safety by telling doctors about other drugs that patients may be taking. Electronic patient records also make it easier to integrate medical services between physicians in primary care and hospitals in the secondary sector.

Health-care systems are now scrambling to make more use of IT. Germany is investing €1.8 billion to develop electronic patient cards by the start of 2006. In France, Philippe Douste-Blazy, the health minister, has announced a plan to computerise health records, partly to control the excessive use of doctors by the country's notoriously demanding patients.

In America, Medicare will insist on doctors using electronic methods for prescribing drugs to elderly Americans after the government starts bearing part of the cost. “The question is when, not whether,” says Mark McClellan, administrator of the Centres for Medicare and Medicaid Services (CMS). He also expects IT to play a big role in new chronic-disease management programmes for America's elderly. For example, PacifiCare, a health insurer based in California, uses modem links with patients suffering from congestive heart disease to check daily on whether they are taking their medicine.

The most ambitious project is under way in Britain. At present, notes on patients are often still held on paper; electronic information is fragmented in locally based systems, and there is a great deal of duplication. The aim is to replace this with a comprehensive national electronic system, costing £6 billion ($11 billion), making it the biggest civilian IT project in the world. By 2007, all prescriptions will be created and transferred to pharmacies electronically. By 2010 the system will provide fully integrated access to patient records for appropriate health-care professionals, wherever they work.

These plans hold out much promise, provided they can be implemented without the usual pitfalls of big IT projects. Experience of IT in other service industries suggests that it has plenty of potential to cut waste and raise efficiency in health care. But, even allowing for worries about patient confidentiality, why has it taken so long in health care? In the mid-1990s, a survey of 53 American industries ranked health care 38th in its expenditure on IT per worker. A similar picture emerged from a British survey of IT spending in 2000 (see chart 8). The banking sector spent nine times as much on IT per employee as the health sector.

This in turn prompts a broader question. The Institute of Medicine report said: “Because of the high levels of waste in the current system, the committee sees no immediate conflict in the simultaneous pursuit of lower costs through efficiency and better patient experiences through safety, effectiveness, patient-centredness and timeliness.” The international evidence of waste and inefficiency suggests that this conclusion holds not just for America but for most other developed economies. So why have strenuous efforts to control medical costs failed to control all that waste?

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Treating the symptoms

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Efforts to contain health-care costs seem doomed to failure

SINCE governments first started to get worried about rising health costs in the 1970s and 1980s, they have tried time and again to check expenditure. The methods have varied from one country to another, and have developed from the crude to the more sophisticated. But all the attempts have one thing in common: any initial success has eventually been reversed by the pressure for higher spending in systems that remain wasteful.

France's recent experience illustrates the problem. The growth in health spending was checked in the late 1990s but has picked up momentum since then, for two main immediate reasons, says Dominique Polton, director of IRDES, a health-economics research institute. First, hospitals are having to hire 45,000 extra staff to cope with the 35-hour working week, which has pushed up labour costs. Second, the fees charged by primary-care physicians were raised sharply after a long period when they had been held down.

However, the structural cause of the financial crisis, she points out, is that previous attempts to contain costs have failed to remove the incentives that encourage medical overconsumption. French patients can choose any doctor, including any specialist, that they want to see. Physicians get a fee for each visit, so they have an interest in maximising visits. France has the third-highest share of privately funded health insurance in the OECD. However, much of it is used to cover against the top-up co-payment—the *ticket modérateur*—which patients make for visits to the doctor and for drugs. This defeats the purpose of the co-payment, which as its name suggests is supposed to moderate demand. Instead, the French consult their doctors at frequent intervals and are the champion pill-poppers of Europe.

Other countries have seen a similar pattern of cost remission followed by a renewed burst of spending growth. In Canada and Sweden, for example, spending was checked for a period in the 1990s, but this has been followed by increases of nearly 6% a year between 1997 and 2002. In Britain, the current spurt in health expenditure comes after a period in the late 1990s when growth in the NHS budget was held down to only 1.5% a year, less than half the average for the preceding 15 years.

Governments' attempts to contain health costs have come in many varieties, including budget caps, usually in the hospital sector; wage controls; price limits on medical fees and prescription drugs; restrictions on the flow of new medical students; and delays in the introduction of new technologies. These techniques work for a while, but eventually they break down. In some cases, wage demands can no longer be resisted; in others, medical providers circumvent price controls by increasing the volume of higher-cost work. However, the underlying reason why these methods fail is that they do nothing to promote greater efficiency. They simply keep a lid on the long-term pressures for more spending generated by improvements in technology. Eventually the lid is lifted by patients' discontent.

Even more sophisticated strategies to control expenditure have been less successful than expected. One example is the reform of payment systems in American hospitals introduced 20 years ago. In the early years of America's Medicare programme for the elderly, established in 1965, spending ballooned. The federal programme had borrowed one of the worst features of private health insurance: the reimbursement of hospital bills. This gave hospitals an incentive to keep patients in for as long as possible and to provide unnecessary services. A reform in 1983 introduced a “prospective” payment system for in-patient services based on the costs of different illnesses and procedures. For each of these diagnosis-related groups (DRGs), hospitals were paid a pre-determined fixed amount per admission.

Initially this led to a dramatic slowdown in cost inflation, but before long expenditure growth took off again as hospitals learned to manipulate the new pricing structure by classifying illnesses into more expensive categories (known as “DRG-creep”), and expanding activities such as out-patient care which were initially not subject to the new payment system. Despite the reform, and its subsequent extension

to other hospital activities and doctors, spending growth per person covered by Medicare has outstripped growth in GDP per person by nearly two percentage points a year since 1990.

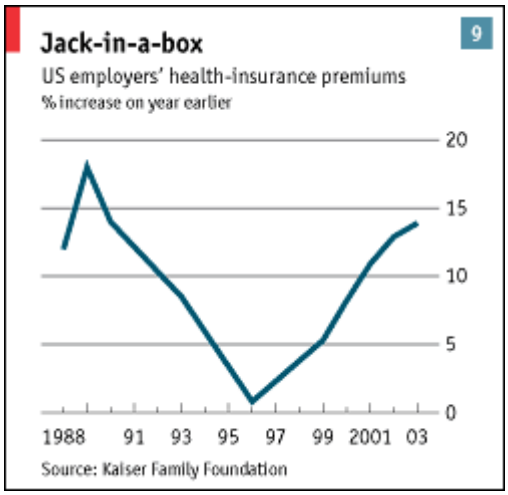
To start with, the reform did indeed spur hospitals to become more efficient. But it failed to deal with the equally fundamental question of whether admission was necessary in the first place, says Gordon Norman, vice-president of disease management at PacifiCare. Furthermore, the politicians controlling Medicare's budget started to use the payment system as a form of price control; and history shows that all price controls end up being busted.

The retreat from managed care

In the light of such lessons, reforms in the 1990s sought to deal with the underlying cause of health-care cost inflation: the ease with which medical providers can pass on costs when consumers pay for medical care through a third party. In America, this took the form of managed care, which spread like wildfire across the employer-financed health market. Employers shepherded their workers into health plans that curbed costs by restricting members' freedom to choose their providers of medical care. Between 1988 and 2000, membership of managed-care plans rose from 27% to 92% of workers with health coverage through their employers.

Managed care comes in many shapes. At one extreme there are HMOs such as Kaiser that restrict members to doctors and facilities within the organisation. At the other extreme, preferred-provider organisations (PPOs) allow members to use doctors and facilities outside the plan if they pay extra. As managed-care plans have evolved, these dividing lines have become blurred. But all health plans have some degree of leverage over the doctors and hospitals in the HMO or PPO, allowing them to negotiate discounts on the price of their services and to exercise some control over the utilisation of medical care.

For a time, the managed-care revolution appeared to be working. The rise in costs in the employer-financed market slowed down (see chart 9). This fed through to a sharp deceleration in the real growth in total health-care spending per person in America, to 2.4% a year between 1993 and 1999, half the growth rate in the previous 20 years or so. The slowdown was an enormous relief to employers. At last, they appeared to have found a cure to the disease of rampant cost inflation in the health sector.



But doctors hated managed care, which attacked both their wallets and their cherished independence. So, too, did American workers, who resented the restrictions it imposed on their choice of doctor and care. “It led to arm-wrestling between the doctors and insurers over the care patients could get,” says Mark Pauly, a health economist at the Wharton School.

As the backlash developed, employers and insurers who organise health-care plans for them backed off. Most managed-care plans have now loosened their restrictions on choice of physicians and utilisation of service. And sure enough, employers' health-insurance costs have returned to double-digit growth.

As the dust has settled, it has become clear that the managed-care revolution was more apparent than real. The aim was to spread the Kaiser model across America, ushering in a new era of competition between Kaiser-like organisations. But according to Francis Jay Crosson, who heads the physicians' side of Kaiser Permanente, the company's culture has developed over many years and could not be replicated elsewhere overnight just because the insurers required it. Mr Pauly puts it differently: “Managed care seems not to have met the market test.”

So what started as a revolution turned out to be mainly a mechanism for insurers to secure price discounts from physicians and hospitals. One reason why economies were possible to begin with was that America started the 1990s with a lot of excess capacity in medical care, says Mr Norman of PacifiCare. However, by the end of the 1990s that surplus capacity had been absorbed, and the flimsy organisations set up by most insurers were unable to secure real improvements in cost-effectiveness.

The verdict on managed care is that, like every other cost-containment strategy before it, it treated the symptoms. It would be wrong to write off all past attempts to restrain health-care costs: the development of “prospective” payment systems for hospital services, for example, is a useful building-

block for further reform. But it is striking that despite all the efforts to control costs over the past 20 years, waste has remained rife. “Just trying to squeeze costs won't work,” says the OECD's Ms Docteur. “You have to change the medical-care delivery system fundamentally.”

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New remedies

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There must be a better way

THE chronic malfunctioning of health-care markets suggests a simple solution. Instead of restricting individual consumers, let them exercise choice. It works in other markets: why not in health care?

The usual answer has been that consumers of medical services lack the information to make informed choices. In an emergency everyone must rely upon the professional skills and commitment of the local hospital. But at other times too, patients are bound to look to their doctors to guide them through the complexities of medicine. If doctors are hard-pressed to master an ever-growing volume of clinical research, what hope for the lay person?

This information gap makes it much more difficult to exercise consumer power in health care than in other markets. Decisions about treatment are delegated to the very physicians who also provide and commission medical care. This is why some health economists favour government intervention, so that a powerful single payer can counter the might of medical providers.

Yet this judgment about the inherent weakness of consumer power is increasingly challenged, and in some unlikely quarters. Take Britain's NHS, where the government holds both the financial purse-strings and organises the provision of health care. An unpropitious setting for consumer choice, you might think; but patients needing elective treatment such as hip replacements will be able to choose among four or five hospitals by the end of next year and among any by 2008. The Labour government is anxious to make the publicly run health service more personal and to give consumers more choice.

Within the medical world, it is increasingly accepted that health care must become more patient-centred. As chronic diseases have become more prevalent, the idea of “expert patients” who play a vital part in managing and controlling their medical conditions has come to the fore. The evidence suggests that such patients do better, at lower cost, than those held to a more passive role.

One factor in empowering health-care consumers is the internet. A report in 2002 found that over 70m Americans had used it for health information, and that 6m were using it daily. With more knowledge at their fingertips, Americans are distinctly unhappy about the value for money delivered by medical care. “Consumers are aghast at costs and are increasingly aware of quality problems,” says Margaret O'Kane, president of the NCQA.

Consumer power

This is providing the private health-insurance industry in America with an opportunity for a change of tack. After the backlash against managed care, it is now seeking to delegate more responsibility to individual consumers, mainly through plans with more cost-sharing by way of higher co-payments. According to James Robinson at the University of California, Berkeley, this amounts to the reinvention of health insurance for the consumer era. Regina Herzlinger of Harvard Business School, editor of a recent book entitled “Consumer-Driven Health Care”, believes that only consumer power can cure America's sick health-care system. The information may be complicated, she says, but the same is true of many other markets that consumers have successfully navigated.

If individual consumers are to take more control of their health care, they will have to save as well as insure. In America, new tax breaks on health savings accounts make it attractive for individuals to build up nest-eggs to pay for their increased share of the cost. Such accounts belong to the employees and are portable, unlike those under previous schemes. “This changes the employer insurance system in a pretty dramatic way,” says Robert Moffit of the Heritage Foundation.

Greater emphasis on individual consumers is overdue, and is likely to affect providers too. Ms Marsh, the boss of Stanford Hospital, accepts that when individuals pay a bigger share of the bill, hospitals will come under greater competitive pressure. But none of this is likely to bring about a fundamental transformation. For one thing, probably only a relatively small minority of Americans can afford to save for health care. And a bigger share for out-of-pocket payments does not necessarily constrain health budgets. In Switzerland such payments are especially high, yet the country's overall expenditure on health as a share of GDP is second only to America's.

More important, consumers will still have to combine these new savings accounts with health insurance. Again, the experience of Switzerland is discouraging, because it shows that choice in health insurance can lead to perverse outcomes. Since 1996, members of the compulsory state health-insurance scheme there have had a choice between competing insurers, all of which had to provide a standard package of benefits. The reform was intended to enhance competition among insurers. But rather than wringing better deals from medical providers, insurers have gone for the best risks, despite a “risk equalisation” scheme that takes account of age and sex. Those companies able to attract the healthier members have been able to keep premiums down, which in turn has attracted more healthy members.

Because the competition has concentrated on risk selection, it has not had the desired bracing effect on medical providers, so health spending has kept on growing. Konstantin Beck, chief statistician at CSS, the biggest insurer in this system, which has ended up with more than its fair share of bad risks, explains: “The loyalty of high risks can kill an insurer.” Mr Zweifel of Zurich University, one of the intellectual architects of the Swiss reform, admits that the results have been disappointing.

In America, risk selection is tempered by the link between insurance coverage and employment, which means that insurers chosen by employers have to offer coverage to all employees. Yet the practice is widespread in the individual market, says Bruce Bodaken, chairman and CEO of Blue Shield of California, which insures 2.7m members. Mr Bodaken believes that health insurers should have to accept all-comers in a system with effective risk-equalisation. “Then we would compete on service and quality instead of risk, which is an interesting idea,” he says wistfully.

But this interesting idea is based on the premise that effective risk-equalisation is possible; and experience to date suggests that it is extremely difficult. New methods, which include information on health status, are now starting to be used—for example in the Netherlands and Germany—but they are complex and have yet to prove themselves. The danger with unleashing the consumer on the current system is that it will intensify the pressure for more risk selection, says Ms Docteur of the OECD. This form of competition does nothing to serve the general interest in holding down costs, inefficiency and waste in the delivery of medical care. Furthermore, a reform that makes it difficult for the unhealthy to get affordable cover is likely to prove politically unsustainable.

For the moment, health-care reform should concentrate on promoting greater competition among providers. That requires health-care insurers and public payers to become more effective purchasers of medical care. Until now they have been stymied by a critical lack of information about the quality of the medical care they are buying. According to Suzanne Delbanco, executive director of the Leapfrog Group, an employer-backed organisation seeking to raise standards of care in American hospitals, health-care purchasers are “paying the same, good or bad, free of mistakes, fraught with mistakes.”

Best practice

The development of quality standards and report cards, bringing greater transparency to the medical-care marketplace, could make a big difference. In America, a number of promising initiatives are beginning to have an effect. The NCQA started by monitoring the quality of insurers' health-care plans, but has branched out to include assessments of medical provision. Since 1997 it has run a programme to give recognition to doctors and medical groups meeting quality standards for the treatment of diabetes. In 2003, a similar recognition programme was launched for doctors looking after patients with heart disease or strokes.

The Leapfrog Group, set up nearly four years ago, initially homed in on three ways to make hospital care safer, chosen for their potential for saving lives: computerising drug prescribing, putting intensive care under specialist management and concentrating high-risk procedures in hospitals with a sufficient volume of work to develop the necessary expertise. Already 60% of hospitals in regions accounting for almost half of the American population are reporting on their performance under these headings. Now they are also being asked to report on 27 other practices which will be compiled into a quality index.

On the west coast of America, PacifiCare is using its internal claims data to provide quality reports on medical providers. In Los Angeles County, for example, the best-performing network of medical groups is 20% cheaper and its quality scores are 20% higher than those of the lesser performers. Since PacifiCare started publishing these report cards in 1998, members have been voting with their feet: every year, 6.5% of them switch to the best provider. “This forms part of a broader emphasis on evidence-based medicine,” says Sam Ho, the insurer's chief medical officer. “Physicians need to know more about the effectiveness of their diagnostic and treatment efforts.”

In other countries, reforms are increasingly aimed at the supply side of health care. One building block is the introduction of “prospective” payment systems for hospital services. These are now used outside America—for example, in Australia and Sweden. Britain and Germany are moving the same way, and hope to have the new payment systems up and running within four years. As in America, these are likely to do some good at first, because they show up the poor performers and create pressures on the hospitals to become more efficient. But the governments will have to hold their nerve. In Britain, the new tariff could mean that some hospitals will lose 30% of their revenues, according to John Appleby, an economist at the King's Fund, a health-policy think-tank. In Germany, Christoph Fuchs, managing director of the German Medical Association, puts it this way: “We expect a lot of hospitals will close as a result.”

Without further reforms, these new payment systems are likely to degenerate into another form of price control. Encouragingly, however, governments are also striving to create more competition among providers. In Germany, the government is promoting integrated care programmes that span the primary and hospital sectors and is encouraging the formation of new medical groups to carry out the work. “It's the most important step so far to lower the barrier between hospitals and other medical-care providers,” says Mr Busse of Berlin's Technical University.

In Britain, the Labour government belatedly realised that structural reform was needed if the vast sums of money being poured into the health service were not to be wasted. Following a major policy shift after the 2001 election, the NHS is now being reorganised into an internal market, something first tried by the Conservatives in the 1990s but dropped by Labour after it won power in 1997. Most health care is now bought by locally based primary-care organisations. Public hospitals are being given greater autonomy so that they have more incentive to compete. Under the new payment system, the more patients they have, the more money they will get.

Try globalisation

In a further attempt to ginger up the supply side, the government has attracted foreign medical groups into the NHS market. They have won the lion's share of an innovative five-year tender for 250,000 elective operations a year. That amounts to only 5% of the 5m elective operations carried out in the NHS in 2002, but the entry of new competitors is sending out a powerful signal to inefficient hospitals in the state-run sector. The government is now planning for private providers to carry out up to 15% of NHS elective procedures as early as 2008.

But whereas Europe is making progress, in America there are worrying signs that the supply side is becoming less rather than more competitive. A wave of consolidation among hospitals has strengthened their position in the local marketplaces within which they operate. Most of them have been in the not-for-profit sector, but that does not stop them from exploiting their enhanced power in the market. Recent

research by Martin Gaynor, an economist at Carnegie Mellon University, shows that mergers, whether in the for-profit or not-for-profit sector, can push up prices by over 50%.

This wave of consolidation requires a firm response from America's antitrust authorities, which to date have challenged few of the mergers. So far the courts have been sympathetic to the hospitals' argument that as not-for-profit organisations they would not exploit any market power gained by the mergers. But the courts may become less indulgent as it becomes clear that this argument is bogus.

All in all, the new ideas now being explored to reform health care have considerable potential. Unlike earlier containment policies, they are aimed at the structural elements of the medical marketplace that push up costs even in the presence of much waste. Yet there is still much work to be done before health-care systems offer better value for money.

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Keep taking the medicine

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Reform will be slow and difficult, but there is no alternative

HEALTH care in rich countries presents a paradox. On the one hand, advances in medicine are extending life and improving its quality—gains of great value to those who benefit from them. On the other hand, the evidence of error rates shows that hospitals and doctors routinely break the first rule of medicine, to do no harm. Widespread waste is evident, yet the costs of health care spiral ever upwards, causing increasing alarm among individuals, employers and taxpayers. Medical costs are so buoyant that all containment strategies seem doomed to eventual failure.

The revelation that much health care is of poor quality poses some troubling questions for the medical profession in rich countries. “There has to be a shake-up in the medical world, led by the medical world,” says Mr Bodaken of California's Blue Shield. Doctors have traditionally treasured their independence and resisted outside interference. But medical care is now delivered through expensive, complex systems that require sophisticated management to avoid errors, to ensure that patients get appropriate advice, tests and treatments, and to keep costs as low as possible. Doctors need to be able to work collaboratively in teams spanning professional boundaries. Medical education, still locked in an old-fashioned apprenticeship model, should prepare doctors for these new demands. Alain Enthoven of Stanford University says that teaching doctors how to deliver cost-effective care will require a transformation in medical training.

A long, cool self-appraisal by the medical profession is essential, but on its own it will not be sufficient. Doctors and hospitals around the developed world preside over a seriously defective system of medical-care delivery, which will need comprehensive re-engineering. Information technology will play a big part in this, but in itself it will not transform health care without the right incentives.

What is needed is a change in the structure of health-care systems so that competitive pressures push them in a more useful direction, enhancing the power of purchasers and increasing competition in the supply of medical care. The traditional argument has been that health care is too important to leave to the market. The opposite holds true: it is too important not to be exposed to the market.

What governments can do

That requires rethinking by government, which is intimately involved in all health-care markets because it picks up so many of the bills. That involvement can be made much more constructive. Instead of trying to supplant the market, governments should be striving to promote competition while upholding social

values about equity in health care. Thus in Britain, a Labour government now sees no contradiction between its historic commitment to free services by doctors and hospitals and the pursuit of an internal market in the NHS. In countries where there are competing insurers, governments can direct public money to poorer and sicker people so that they can afford insurance, organised in a way that fosters effective competition for better medical care.

Another lesson is that just because governments finance so much of health care, they do not necessarily have to provide it themselves. Britain's NHS employs 1.4m people, making it the world's third-biggest employer, surpassed only by China's Red Army and the Indian railways. This monolithic grip on the provision of medical care has inhibited the experiments that flourish when the ownership of hospitals is more varied, and has contributed to poor morale in the workforce.

Governments should also review their role as regulators. Historically, regulation has tended to block competition, for example by preventing health-care purchasers from selective contracting with providers. A better role for regulators would be to sponsor competition. Regulators should also set out quality standards and monitor performance, building on some of the initiatives that are already proving their worth in America.

The re-engineering of health care will certainly require a reform in the way that medical providers are paid. “Changing the payments system is indispensable,” says Ms O'Kane of America's NCQA. The aim is clear: to pay doctors for doing the right thing at the right time. The best way of getting there is less obvious. Fee-for-service payment promotes productivity but also encourages over-use; conversely, paying doctors a straight salary in heavily regulated markets may lead to underperformance, because it fails to reward productivity. Successful reform will involve remoulding payments systems so that they reward quality and performance. “What we're trying to move towards is more financial incentives in paying directly for better outcomes, in paying directly for steps that reduce costs of care,” says Mr McClellan of America's CMS.

There is no one-size-fits-all model of health care. Health systems have evolved in diverse ways that reflect individual countries' values and histories. The important thing is to change these structures so that they encourage medical providers to do better, not to rebuild them from scratch.

Nor is a “big bang” advisable. America's attempt at introducing universal health-care coverage in Bill Clinton's first term of office was an abject failure. Since then there has been political gridlock in Washington, says Henry Aaron, a health economist at the Brookings Institution. The best way to proceed now, he says, is to let individual states experiment with new ways of extending coverage. Mr Moffit of the Heritage Foundation agrees, saying that America is too big and too diverse for a single national solution.

The difficulties of reform should not be underestimated. Today's medical-care systems are underpinned by powerful vested interests. Every dollar saved by using more cost-effective procedures is someone's dollar of income. But the prize of transforming today's underperforming health systems into the sort that will produce high-quality yet affordable health care is worth putting quite a few noses out of joint.

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America's business backlash

The uncertain return of the hero boss

Jul 15th 2004 | NEW YORK
From The Economist print edition

The business backlash in America may be losing some of its energy

HAS Donald Trump saved American capitalism? Investors in the real-estate mogul's duff Atlantic City casino business are unlikely to agree. They are getting stiffed with a low share price and a probable debt restructuring. But Mr Trump's small-screen triumph as a reality-TV star is helping to revive interest in a figure not seen in public since the bursting of the stockmarket bubble in 2000-01: the celebrity boss. Even as erstwhile heroes of capitalism are led away in handcuffs, Americans seem to be flirting with the idea of falling in love with the boss all over again.

Naturally, the transition from one era to the next requires some finessing. The cover of *Fortune* magazine, for instance, recently featured a somewhat mixed message about the boss of InterActiveCorp ("Is Barry Diller's company the real thing or just another house of cards?"). But it has also drooled in less-restrained fashion over IBM's boss, Sam Palmisano, Ford's boss, Bill Ford, and the curiously telegenic Mr Trump ("He's never been hotter").

The popularity of Lou Dobbs, a TV anchorman who administers nightly lashings to America's corporate elite, may have peaked: his audience has shrunk in the past couple of months, says Nielsen Media Research. In the recession, the average job tenure for chief executives fell to five years. Now it is rising again. Even celebrity ex-bosses may be getting gentler treatment. Some of the media coverage after the arrest on fraud charges on July 8th of Kenneth Lay, Enron's former chairman, was surprisingly friendly, say his lawyers, pointing to reports in the *New York Times* and *Washington Post*. Mr Lay has since been on prime-time TV joshing with host Larry King. "Great meeting you, Ken," Mr King wrapped up.

Trust me, I'm a boss

After two years of tough regulatory enforcement, new laws, high-profile trials and a hostile press, public anger towards business seems to be fading somewhat. A recent poll by Gallup shows that public confidence in big business is up for the second straight year, albeit from a 30-year low. The legislative cycle may have run its course. The Sarbanes-Oxley act, which introduced many rules governing boardroom behaviour, hurtled unimpeded through Congress in 2002. This year's most important rule-making effort, an initiative by the Securities and Exchange Commission (SEC) to introduce a mildly less undemocratic system for electing board directors, has come under possibly mortal fire from a

reinvigorated business lobby.

Although the most recent “proxy season” saw a record number of shareholder resolutions, there are even signs that the attitudes of “activist” shareholders are starting to soften. One revealing bellwether: the attitude of Institutional Shareholder Services (ISS), a corporate-governance advisory firm, towards offshore incorporation. In 1999, ISS advised investors to vote against a shareholder proposal asking that Tyco reincorporate from Bermuda back to America, citing the tax benefits of incorporating offshore. In 2003, after a scandal at the firm and cries from politicians about “unpatriotic” bosses, ISS reversed itself and told investors to vote for reincorporation in America, helping to deliver a big protest vote. This year, ISS changed tack again and voted with management for the Bermudan tax advantages.

Further signs of a change in the weather come from this year's presidential race. John Kerry, the Democratic contender, opened his campaign on a conspicuously anti-business note, lambasting bosses who outsource jobs abroad as “Benedict Arnold CEOs”—an allusion to a famous American traitor. The Kerry campaign has kept up some of its big-business-bashing rhetoric. Recent campaign adverts bill his running mate, John Edwards, a former trial lawyer, as “the son of a mill worker who took on powerful interests in the courtroom—and then carried his fight for the powerless all the way to the US Senate.” On the whole, however, Mr Kerry has backed away from his earlier remarks, as much of the anti-business venom has drained from the offshoring debate.

Mark Roe, a Harvard Law School professor, calls such periodic swings in sentiment against big business “backlashes”. These occur, argues Mr Roe, following periods of greater economic freedom. Freedom promotes efficiency: small firms merge with each other to form bigger ones, which produce at greater scale. It also promotes inequality and erodes social cohesion, as the power and wealth of the managerial class grows along with companies. This creates envy among workers, and the potential for political instability.

Some countries have developed practices that help to suppress backlash, says Mr Roe. Half of the supervisory board seats at German firms are reserved for labour representatives. This checks growth in executive pay and gives workers a voice in management. Income inequality is bigger in France than in Germany. But French companies cannot easily sack employees, giving workers the power of tenure. Other countries, such as Argentina, lacking such dampening mechanisms, suffer from political instability and even revolution.

America seems to chart a third course. It suffers from business backlashes, but tempers them with ad hoc legislative and regulatory efforts that absorb the worst of the (otherwise) destructive political forces. Thus, America passed its antitrust laws during a backlash against industrial robber barons, the core of its securities laws during a backlash against Wall Street after the 1929 stockmarket crash, and the recent Sarbanes-Oxley act during a backlash against boardroom excess. In this way, argues Mr Roe, America avoids political instability and achieves “soft transformation”. Instead of grousing at the new rules, in other words, American businessmen should be thanking Messrs Sarbanes and Oxley for saving them from the gallows.

If America's latest backlash is now fading, one feature persists: heightened policing. “There is still a tremendous amount of regulatory enforcement going on,” says Martin Lipton of Wachtell, Lipton, Rosen & Katz, a law firm. “The Justice Department's corporate-fraud task force is as active as it has ever been.” The public mood may have been softening, says Mr Lipton, “but I am not at all sure that the regulators agree.”

Perhaps, along with the legislative efforts of Congress, the SEC and the Justice Department draw their strength from political energies that are now fading. America threw its New York Stock Exchange boss in jail long after the 1929 crash. Rudy Giuliani launched a prosecutorial war against Wall Street after the 1980s “decade of greed”. Being slow-moving bureaucrats, the cops may simply lag the cycle.

But maybe the extra cops are here to stay. America's latest backlash followed an unprecedented boom in executive pay, with a typical top chief executive's remuneration up from 40 times that of an average worker in 1980 to 500 times by 2000. Most of those gains in pay have persisted. Tougher regulators and harsher justice for business crooks may be the glue that binds increasingly unequal Americans together. By all means, play the well-paid hero boss again. But also be prepared for jail.

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Defence contractors

EADS for sale

Jul 15th 2004
From The Economist print edition

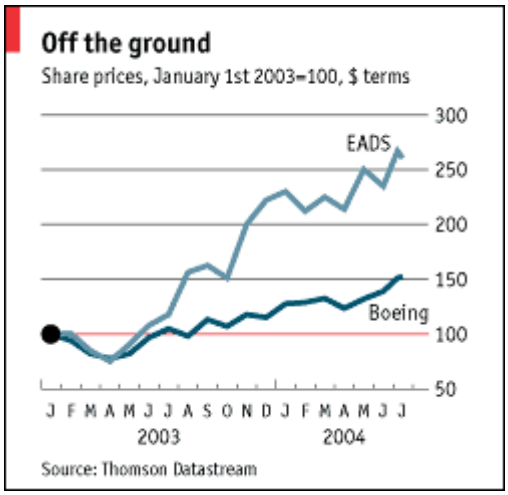
The biggest shareholders in EADS are preparing to sell up

THE prime ministers of France and Germany met in Strasbourg to announce its creation five years ago; the French government holds a 15% stake. It makes the Eurofighter, and owns 80% of Airbus. But Europe's quintessential industrial champion, the European Aeronautic Defence and Space (EADS) company, is preparing to become a genuine global firm.

The Economist has learned that it is heading for a big shake-up of its ownership. Its three biggest shareholders, the French Lagardère conglomerate, the German car group DaimlerChrysler and the French government, are planning a co-ordinated sale of their stakes in 2006 or 2007.

Philippe Camus, EADS'S co-chief executive, is coy. He will say only that the company is content to wait for a review of its shareholdings in 2006. But industry sources suggest that the shareholders are working out how to proceed in harmony in order to get the best price for such a mammoth share sale. On today's valuation the sale would be worth a whopping €30 billion ($36 billion).

The sale will probably be done through a private placement with big investors. Only about one-third of EADS shares now trade in the market, and their recent strong performance (see chart) shows that demand for them is strong. American institutional investors could be eager buyers, and that could make it easier for EADS to sell its wares in America.



It wants to boost its defence and space revenues from €7 billion now (out of total revenues of €30 billion) to €10 billion. Although its orders from America are now worth less than €1 billion, it has a toehold in the world's biggest defence market, selling helicopters and marine-surveillance aircraft assembled or adapted in factories in Mississippi, Texas and Alabama. Now it wants more. And Boeing, its big American rival, is struggling: ethical problems are delaying a $22 billion order from the Pentagon for air-to-air refuelling tankers.

EADS hopes this will give its Airbus alternative a chance to snatch at least some of the American tanker business from Boeing. But to do so, EADS knows that—with its likely American partner, Lockheed Martin—it will have to invest heavily in American facilities to convert Airbus passenger jets for military use. It takes factories and jobs on the ground to win congressional approval for defence orders.

Currently EADS is thoroughly European, and is regarded by Americans as the more suspicious for that. DaimlerChrysler owns 30.1%, whilst a French holding company (jointly owned by Lagardère and a French government body) holds another 30.1%. A Spanish state holding company, SEPI, owns 5.5%, with the remaining 34.3% held by institutions and individuals.

The Lagardère media-to-missiles group has made public its intention to get out of defence aerospace. The French government is thought to be keen to proceed with a privatisation that would be less controversial than selling Electricité de France and easier to offload than its stake in Air France. DaimlerChrysler could use the money for its core car business, though it denies any intention to sell.

The timing of the share sale would aim to capitalise on the entry into service in 2006 of the A380, a double-decker 555-seater plane that the EADS Airbus division hopes will supplant Boeing's 747. If that

prompts a wave of new orders, the shares could command a premium.

So far, Airbus has 129 orders and firm commitments for its “super jumbo”—but it needs almost to double that to earn a profit. The hope is that taking to the air with launch customers such as Singapore Airlines will lead to further orders from other carriers, such as Cathay Pacific and British Airways, which fly busy long-haul routes. Much, then, is riding on the success of a plane that Boeing dismisses as a white elephant. A big order for the A380, rumoured to be announced at the opening on July 19th of Farnborough Air Show, could be another straw taking off into the wind.

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Offshoring

More gain than pain

Jul 15th 2004
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Why America wins, but Germany loses

NO WORD scares the world's hand-wringing professional classes so much as “offshoring”. Even journalists fear being replaced by some keen—and above all, cheap—young thing in Bangalore. No wonder a debate rages about the merits, or otherwise, of moving jobs offshore. Is offshoring a “hollowing out” of rich-country jobs? Or does it provide benefits to rich and poor countries alike, while harming few workers? Actually, both claims may be right. Just compare Germany and America.

According to a new study from the McKinsey Global Institute, every dollar of corporate spending shifted offshore by an American firm—mostly, now, to India—generates $1.13 in new wealth for America's economy. However, when a German firm moves a euro to a cheaper place to buy services, its home economy is on average 20 cents worse off.

German firms send roughly 60% of their “offshore” work to eastern Europe, and only 40% to India. American firms steer much more of their offshore work to the subcontinent, which is cheaper. While firms in both Germany and America are able to cut costs steeply by offshoring, the Americans save 20% more. Moreover, says the study, America's economy is more likely to benefit from all those Indian body-shops buying American products, ranging from Dell computers to the Coca-Cola that fuels programmers' late nights. German products are less enticing. And American shareholders are more likely than German investors to have a stake in an Indian offshoring company, further increasing America's gains. Yet all of this still only explains a small part of America's offshoring advantage.

The biggest difference emerges when workers who have been fired in the offshoring process look for new work. In America, McKinsey estimates that around 70% of workers ousted in favour of offshore alternatives find new work within six months. In Germany, however, the re-employment rate is only around 40%. The reason? Above all, Germany's thicket of labour laws, which discourages firms from hiring workers who may prove a hard-to-shed liability. Admittedly, these same laws—which are increasingly under fire (see article)—also make it harder for German fims to shed workers to take advantage of efficiency-enhancing offshoring. The lesson: offshoring may be an easy target for politicians, but if they have flexible labour markets it may actually be a good thing, not just for big firms, but for everyone.

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European competition policy

Monti's moment

Jul 15th 2004 | BRUSSELS AND PARIS
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France Telecom could provide the last test of Mario Monti's resolve

MARIO MONTI, the European Union's (EU) competition commissioner, is busily tidying up loose ends for his successor. On July 7th, the day that the European Commission gave its final blessing to a French government-aid package for Alstom, a troubled engineering group, Mr Monti introduced new rules to govern future state bail-outs. Then on July 12th he said that he would decide shortly whether the commission will order France Telecom to pay the French government around €1 billion ($1.2 billion) in taxes that went uncollected in years past. And he will soon make up his mind about a proposed €400m loan by Italy's government intended to keep Alitalia, the country's ailing national airline, airborne a while longer.

Mr Monti's new rules on state aid provide a clearer policy framework and give EU member states less room for manoeuvre to negotiate a backroom deal *à la française*. They make it clear that the "one time, last time" rule on doling out emergency cash applies to all companies for ten years. The rules also require companies, once they have recovered, to pay back fixed amounts of state aid according to the size of the firm in question—one-quarter of the state's rescue aid for small firms, at least 40% for medium-sized firms and at least half of the cash for big companies. The rules also introduce a new concept, urgency aid, which allows firms to start restructuring whilst working out a definitive plan for reform or liquidation.

Before the new rules become effective in October, Mr Monti will fight at least one more battle with the French government, this time over allegedly illegal tax subsidies and supposedly favourable treatment of a loan to the partially-privatised France Telecom in 2002. Commission staff claim that in the 1990s the telecoms giant was partly exempted from a French business tax usually levied at the local level but paid directly to the finance ministry by France Telecom under a special arrangement. Despite some internal scepticism about the case, the commission also launched an inquiry into a €9 billion loan granted by the government to France Telecom to clear its debts. France Telecom says that the tax exemptions were owed because it had previously overpaid the business tax, and it vows to take its case to the European Court of Justice if Mr Monti decides against it.

Closing France's ever-open helping hand for sick companies has been a tough challenge for Mr Monti. In the 1990s, the French government repeatedly bailed out Air France, its national airline, and Crédit Lyonnais, a state-owned bank until its privatisation in 1999. Last year the commission filed a lawsuit against the French government in the European court, aiming to force it to reclaim an emergency loan to Bull, a troubled computer maker.

Though he has often compromised in French state-aid cases, Mr Monti has generally been good at his job. He is leaving a stronger EU competition department with more effective rules to govern state aid, mergers and antitrust.

Many countries are now battling to have their own candidate replace Mr Monti in the commission that will take office in November. Jacques Barrot, a Frenchman and EU commissioner for regions, has even decided to spend two weeks at a language school in Britain to brush up his English, hoping (it is said) to boost his chances of being competition commissioner. But France has too many contentious competition issues to be allowed in the driver's seat, says Eric Morgan de Rivery, a lawyer at Jones Day. The smart money in Brussels is being bet on another candidate. Another term, Mr Monti?

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Law firms

Global elite

Jul 15th 2004
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The latest global rankings of law firms

CLIFFORD CHANCE may still be the world's biggest law firm in terms of both turnover—£950m ($1.7 billion) in 2003-04—and the number of lawyers employed (2,945). But measured by average profits per equity partner (PEP), the struggling London-based firm ranks a mere 14th in the "global elite", according to *Legal Business,* a British trade magazine. Its estimated PEP last year (as private partnerships, law firms never publish their results) was £558,000, down by nearly 13% compared with the previous year. This is less than half of the estimated profits per partner of each of the four New York firms that sit at the top of the list.

The law and the profits

Top global law firms, by estimated profits per equity partner (PEP), 2003-04

Firm	PEP £'000	% change*
Cravath, Swaine & Moore	1,289	-1.4
Sullivan & Cromwell	1,265	10.3
Simpson Thatcher & Bartlett	1,204	-2.1
Davis Polk & Wardwell	1,166	-1.5
Skadden Arps	995	-7.0
Cleary Gottlieb	918	-4.7
Shearman & Sterling	862	1.4
Slaughter and May	837	-5.5
Latham & Watkins	790	3.9
Herbert Smith	703	-5.0
Linklaters	670	-8.7
Freshfields	665	-5.0
Allen & Overy	624	-7.6
Clifford Chance	558	-12.7
Sidley Austin Brown & Wood	554	2.0

Source: *Legal Business* *Over 2002-03

To be included in *Legal Business*'s global elite, a firm must be among the world's 50 most profitable; have a disproportionately high number of *Fortune* 250 or FTSE-100 clients; be a leader in its home jurisdiction in at least two of three key practice areas—finance, mergers and acquisitions (M&A), or litigation; be regarded as serious competition in either M&A or finance by the top firms on both sides of the Atlantic; have access to the highest quality German lawyers; and have at least one overseas office. As a niche M&A firm without global ambition, New York's Wachtell, Lipton, Rosen and Katz, the world's most profitable law firm with an estimated PEP of nearly $2.9m in 2002-03, has not been included as it does not satisfy those criteria.

Many factors other than good old-fashioned excellence influence profitability per partner, including the type of work performed (M&A is much more lucrative than, say, litigation), the degree of international outreach (overseas offices are expensive to run) and the proportion of equity partners to the total number of lawyers. (The smaller that proportion, the bigger the profit share-out per partner.) Among the global elite, this ranges from a mere 11% of lawyers who are partners at Herbert Smith to 27% at Latham & Watkins. But in most of the global elite firms, the proportion of partners is around 20%.

Is small necessarily beautiful? Or are America's typically slimmer, less internationally-oriented global elite firms more successful than their English counterparts for other reasons? Opinions differ. Certainly, the top seven on the global ranking are all members of New York's "charmed circle", and all but one have fewer than 850 lawyers. Among the five elite firms with the lowest profits per partner on the other hand, all but one are members of London's "magic circle" with a workforce of 2,300-3,000 lawyers each.

The fact that Slaughter and May, the smallest of London's magic circle firms with 724 lawyers, is also its most profitable would seem to lend further support to this theory. But it is also the least international of the London firms. As with most of New York's top firms, fewer than a quarter of Slaughter and May's lawyers work abroad, compared with well over half at London's other big firms, and nearly two-thirds at Clifford Chance. So, although it seems to pay to be charmed rather than magic, the real key to lawyerly profit may be to be inside a well-connected circle of some sort, and to remain small enough to focus on the most lucrative work.

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Law firms in Japan

Legal entry

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Japan's lawyers discover globalisation

THERE may be other deals just like it over the next nine months. On July 12th, Linklaters, a global law firm based in Britain, announced that it will absorb 20 to 30 Japanese lawyers next spring from the firm of Mitsui, Yasuda, Wani & Maeda. Two of the local firm's senior partners, Mitsuhiro Yasuda and Akihiro Wani, will join Linklaters as part of the deal, which follows reforms approved by Japan's parliament last year. Beginning in April 2005, Japanese law firms will at last be able to merge fully with foreign ones. Other foreign legal firms are now lining up to attract Japanese talent. The biggest winners, however, will be globally-minded Japanese businesses, which will find it easier to tap the legal services they need.

Until now, foreign law firms have had to follow cumbersome rules in Japan. Although they can co-operate with local law firms, they must form local joint ventures and keep them entirely separate from their global practices. This arrangement suits the Japanese bar, which fears that, if Japanese lawyers are able to join global legal practices freely, local law firms will get clobbered in the competition for talent.

Robert Grondine, a partner at White & Case in Tokyo, says that the Linklaters deal proves that Japanese lawyers and their clients—despite claims by local practitioners that Japan is somehow unique—will respond to market forces in the same way as those in other countries. “Where the legal market has basically been opened up,” says Mr Grondine, “you have medium-sized firms deciding to affiliate themselves with international firms”, because of the pressures from clients whose needs have changed because of globalisation.

Mr Grondine points out that the same sort of shift happened throughout Europe in the 1990s. When the European Union's antitrust authorities required cross-border competition in legal services, many local lawyers jumped into the arms of pan-European or global firms at the first opportunity.

In Japan, business clients who want to tap global capital markets or do deals with foreign firms, have been itching for a more seamless link between the Japanese legal system and financial centres such as London and New York. Linklaters, for example, has a strong practice in capital markets, and many of the Japanese lawyers whom it will be absorbing have similar expertise.

Parties involved in cross-border mergers also want a simpler approach. Casper Lawson, a partner at Linklaters in Tokyo, says that both his firm and Mitsui, Yasuda, Wani & Maeda, for example, have been independently advising a big global investment bank on a private-equity deal involving foreign buyers. “When we told them [our two law firms] were getting together," says Mr Lawson, “they were delighted.” With Japan starting to generate more cross-border mergers, there is no good reason why its lawyers should be different.

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Hotels

Out of rooms

Jul 15th 2004
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Hoteliers increasingly prefer running hotels to owning them

YOUR core business is running hotels. Should you own the buildings too? InterContinental Hotels, British-based but with some 540,000 rooms worldwide, has decided not. It is not alone.

InterContinental operates worldwide under its own name, and through such brands as Crowne Plaza and Holiday Inn. Once part of Six Continents, a British brewing, pub and hotel group, it was demerged in April 2003. Many of its 3,500-plus hotels were franchises, but those it owned were worth some $6 billion. Since the demerger it has sold 28 of these for $600m and put 13 others, worth over $200m, on the market. This week it announced that of the 160-odd it still owns, 20 more, valued on its books at $950m, are to go. The sales have been widespread: in America, Australia, Britain and even Vanuatu, a collection of islands in the south Pacific. The new list is headed by InterContinentals in Chicago and Miami.

Why sell now, when the trade is getting back on its feet after three grim years? Because the bad times have taught hoteliers a lesson: except in the carefree late-1990s, their return on the billions tied up in bricks and mortar was lousy. Far better to sell, and return some money to shareholders (InterContinental plans an “initial” $460m buy-back of its shares, of which it has already spent $260m). Then focus on running the hotels well.

The thought is hardly original. In 1993, American-owned Marriott International transferred all its hotels, along with much of its debt, into a real-estate investment trust (REIT), a vehicle allowing public-market investors to put their money in property. But Marriott and the REIT remain close. A better example is Hilton Group, British-based owner of the brand outside North America: since 2000 it has slimmed the $4 billion of hotels it used to own. It still owns about 70 of its 400-plus hotels, but this is under “close review”.

Sale-and-leaseback is the obvious exit route, and can attract financial institutions too, eager for assets that let them diversify out of shares and bonds. Hilton in 2001 thus sold $440m of hotels to Royal Bank of Scotland (RBOS), and $515m more in 2002 to a rival Scottish bank; RBOS had meanwhile put a further $1.75 billion into a deal with up-market Le Meridien. This week Travelodge, a small British budget-hotel operator, said it hoped to raise $750m by offloading its entire estate this way. These deals require caution: Le Meridien accepted terms so tough that when the recession really bit it had to unscramble the deal. Hoteliers now seek flexible terms that leave some risk with the financiers.

Franchising is the cheapest way to grow. Hilton Hotels, the North American arm of the brand, owns some landmark hotels, such as New York's Waldorf-Astoria, but is mostly a franchise operation; Cendant, an American group with nine brands, is entirely so. French-based Accor is unusual, owning 20% of its 4,000 hotels, with more in France, less in unstable countries: a “risk” rather than “return” strategy.

The hotel recovery, by pushing up values, is a new reason to sell. InterContinental's past sales barely fetched the hotels' book value of $145,000 per room. But future sales could fetch more, especially if a British version of REITS, due next year, includes hotels. InterContinental plans also to sell its half-share of a soft-drinks business left over from its brewing past.

Yet not all hoteliers are retreating to their core skills. Hilton Group made more last year from its British gaming subsidiary, Ladbrokes, than from hotels—and, having sold its casinos in 2000, now plans to re-enter that business. Accor likewise earns a far better return on its fast-growing services, including lunch vouchers and running company canteens, than its hotels. And, albeit for tax reasons, Marriott is yet to get entirely out of a company that makes a clean fuel from coal.

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The business of mazes

Profit and lost

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There's money in mazes

MAKING mazes may not be the oldest profession, but it dates back to at least 1500BC. Even so, it is not a mature industry: a global maze-making boom is under way, thanks, not least, to Adrian Fisher, a British designer. His firm, Adrian Fisher Mazes, creates roughly 90 mazes a year for clients in 26 countries. One of its latest, which opened this week at Dobbies Mazeworld, a theme park in Britain, claims to be the world's longest permanent maze, at over 3.9 km (2.4 miles). But a longer Fisher maze—using 8km of jasmine bushes—is in the works in Yunnan, China, to mark the 2008 Olympics.

According to Mr Fisher, half of the world's mazes were created in the past ten years. He attributes their modern appeal to an age-old desire of families for entertainment that engages young and old together, unlike the latest video game. But there is nothing old-fashioned about the technology that goes into creating today's mazes. Computer design software and global-positioning satellite systems are used to mark out paths on the ground.

Mr Fisher uses all sorts of materials, not just hedges. One of his most popular models is the “mirror maze”, using mirrors to multiply perspective and thereby add to the complexity of wandering through. Although commercial mirror mazes date from the 19th century, Mr Fisher has brought them up to date, spending nearly £500,000 ($930,000) on research and development. One of the most elaborate is a new horror maze in Hamburg, complete with torture tableaux and eerie sound effects. Another craze is the maize-maze: farmers have designs cut into their fields when the plants are still young, bringing in tourists during the summer growing season and a still-sizeable crop come harvest-time.

A maize-maze costs at least £20,000; a mirror maze comes in at close to £500,000. Even so, mazes can be value for money, says David Camp, head of the theme-park practice (really) at Economics Research Associates, a consultancy. While they may lack the “thrills and spills” of a $20m roller-coaster, mazes can improve with age, unlike higher-tech attractions. For farmers facing falling subsidies and foreign competition, mazes offer a route into agro-tourism. Paul Swaffield, an English farmer, says that he would have had to sell his land in Dorset had he not diversified into mazes. His maize-maze brings in 25 times more in entrance fees than the crop does when the maze ends its days as cattle feed.

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Face value

A Rose-tinted vision

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Newscast

Has Stuart Rose seen the future of retailing?

"A BIT boring," is how Stuart Rose describes some of the products sold by Marks & Spencer (M&S). The same cannot be said of the takeover battle that has been waged for arguably the most famous name on the British high street. This week, Mr Rose unveiled a turnaround plan designed to thwart an offer worth up to £9.1 billion ($16.9 billion) for M&S from his retailing rival and former friend, Philip Green. Most shareholders seemed willing to give Mr Rose the benefit of the doubt and accept his promise of jam tomorrow rather than Mr Green's money today. So, on July 14th, Mr Green decided to withdraw his bid.

Mr Rose says that he can transform M&S by going back to retailing basics—not easy in the era of Wal-Mart. M&S's relationship with its customers and suppliers was once admired worldwide. But that was when its St Michael brand of underwear could be found in the top drawer of almost every house in Britain. Retailing has since changed dramatically and traditional stores in almost every country face similar challenges. Speciality retailers, such as America's Gap in casual clothes, Victoria's Secret in underwear and Sweden's H&M in low-cost fashion, are taking business away from department stores and established chains. At the same time, supermarkets have moved aggressively into selling clothes, household goods and prepared meals (pioneered by M&S). The British firm has struggled, sacrificing its legendary high quality and employee-friendly culture to make the cost savings needed to keep profits growing through the 1990s and so meet the short-term expectations of many shareholders.

By June 3rd, when Mr Green, a Monaco-based billionaire who owns the Bhs and Arcadia store chains, launched his latest attempt to buy M&S, the firm was deteriorating fast. Its efforts to transform itself had begun to stall. Its management was floundering. Rumours of Mr Green's pending bid led to a boardroom rout. Mr Rose was quickly made chief executive only days before Mr Green made his bid.

That bid was rebuffed, as was his now-withdrawn later offer, which was potentially worth up to £4 a share. Mr Green says that he was treated with "contempt" by the M&S board, which refused to talk to him. Although he fought valiantly, keeping the British business press gratefully entertained, his defeat may have been sealed the moment that M&S picked Mr Rose.

The appointment of Mr Rose, aged 55, was a masterstroke. The new boss has an impressive reputation, so that, for all the sound and fury, it would ultimately have seemed churlish for shareholders to deprive him of a chance to revive the firm—unless Mr Green had offered silly money, which is not his style. Mr

Rose, who grew up in Yorkshire and was educated at a Quaker boarding school, had long coveted the job. Early in his career, he spent 17 years working for M&S. He knows Mr Green inside-out. Mr Rose helped to rebuild Arcadia and initially had defended it against a takeover by Mr Green before selling to him at a much higher price. But selling M&S to Mr Green never seemed to be on Mr Rose's agenda. Even at £4 a share, he maintained that Mr Green's final offer undervalued the company significantly.

That bid, however, has set the hurdle over which Mr Rose must climb. He believes he can deliver a company worth more than £4 a share. To sweeten shareholders he is selling M&S's financial-services business to HSBC, a big bank, in order to fund a share tender offer worth £2.3 billion, the equivalent of returning £1 per share to investors. Costs will be cut, leading to savings of some £320m in the 2006 financial year. The group's extensive property holdings have also been revalued, upwards.

Yet the really crucial thing for M&S's future is what Mr Rose describes as a return to its core. “It doesn't need revolution,” he says, but, rather, the application of basic retailing skills in lots of areas. For a start, the business has to be made simpler. Compared with when he worked at M&S before, Mr Rose now finds each division operating like a separate company. The supply chain has become slow and over-committed, and stores are cluttered with too many product lines. “Do we need 23 varieties of tomato?”, he asks. Mr Rose's new management team has already started to edit the products on offer, adding some new ones to plug the gaps but eliminating many more. Some 10,000 lines of clothing will be reduced to around 9,000. Its roughly 8,500 lines of home goods will be cut to 4,500. A new venture, Lifestore, specialising in homewares, has been cancelled and the unit's first giant store will be closed. Some of the company's smaller food-only stores will also be closed.

Too many sub-brands have left shoppers confused, adds Mr Rose. Some will be kept, such as Per Una, which has been a successful range of women's clothing for M&S. As part of the new strategy, he has bought this business for £125m from George Davies, the designer who developed it, in order to have control over it. Mr Rose reckons M&S's customer relationship is defined by womenswear. So, if his new team can produce appealing styles at good prices, he believes he can regain the trust of the company's most important group of shoppers.

Rub of the Green

But the transformation cannot be completed overnight; this autumn's fashion lines, for instance, are already fixed, so the new team will not have a chance to make their mark on womenswear until spring 2005. Mr Rose is adamant that he can succeed, and perhaps he can—if his shareholders have patience. Despite its troubles, M&S has much going for it: with 25m customers—around half of the adult British population—it retains a large market share, even in women's underwear (26%). Perhaps M&S will become a powerful example of the merits of takeover battles, even unsuccessful ones—for without the bid, the firm would probably have muddled on without Mr Rose. Alas, that may not provide much comfort for Mr Rose's old friend, Mr Green.

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The diamond cartel

The cartel isn't for ever

Jul 15th 2004 | JOHANNESBURG AND WINDHOEK
From The Economist print edition

Reuters

An Israeli tycoon is helping to force De Beers to surrender its control of the world's diamond market

HOW much turmoil can the diamond industry sustain without shattering? On July 13th in an Ohio court De Beers, the world's largest producer of rough stones, finally pleaded guilty to charges of price-fixing of industrial diamonds and agreed to pay a $10m fine, thereby ending a 60-year-long impasse. De Beers executives are at last free to visit and work directly in the largest diamond market, America.

A few days earlier, on July 9th, the first case of successful industry self-regulation against trade in so-called “conflict diamonds” took place when Congo-Brazzaville was punished for failing to prove the source of its diamond exports. And on June 28th Lev Leviev, an arch-rival of De Beers, opened Africa's biggest diamond-polishing factory in Namibia.

Behind all these events lies sweeping change in an industry that sells $60-billion-worth of jewellery alone each year. For generations it has been run by De Beers as a cartel. The South African firm dominated the digging and trading of diamonds for most of the 20th century. Yet the system for distributing stones established decades ago by De Beers is curious and anomalous—no other such market exists, nor would anything similar be tolerated in a serious industry.

De Beers runs most of the diamond mines in South Africa, Namibia and Botswana that long produced the bulk of world supply of the best gemstones. It brings all of its rough stones to a clearing house in London and sorts them into thousands of grades, judged by colour, size, shape and value. For decades, if anyone had rough diamonds to sell on the side, De Beers bought these too, adding them to the mix. A huge stockpile helped it to maintain high prices while it successfully peddled the myth that supply was scarce.

De Beers has no interest in polishing stones, only in selling the sorted rough diamonds to invited clients (known in the trade as "sightholders") at non-negotiable prices. Sales take place ten times a year. The favoured clients then cut and polish the stones before selling them to retailers.

With its near monopoly as a trader of rough stones, De Beers has been able to maintain and increase the prices of diamonds by regulating their supply. It has never done much to create jobs or generate skills (beyond standard mining employment) in diamond-producing countries, but it delivered big and stable

revenues for their governments. Botswana, Namibia, Tanzania and South Africa are four of Africa's richest and most stable countries, in part because of De Beers.

One family got extremely rich too. The Oppenheimers created the “single-channel marketing” system of shovelling all available stones to the clearing house. They came to dominate De Beers after Ernest Oppenheimer took control of most of Namibia's diamond mines nearly a century ago. He formed a mining conglomerate called Anglo American, before grabbing the chairmanship of De Beers. The family is thought to be worth around $4.5 billion today; Nicky Oppenheimer, Ernest's grandson, is Africa's richest man. The family still owns a more than 40% direct stake in De Beers, and its members—Nicky Oppenheimer and his son, Jonathan—run the firm. It may own more De Beers shares held indirectly through Anglo American's 45% stake.

But this stable, established and monopolistic system is now falling apart. Three things have happened. First, other big miners got hold of their own supplies of diamonds, far away from southern Africa and from De Beers's control. In Canada, Australia and Russia rival mining firms have found huge deposits of lucrative stones: BHP Billiton, Rio Tinto and Alrosa have been chipping away at De Beers's dominance for two decades.

De Beers once controlled (though did not mine directly) some 80% of the world supply of rough stones. As recently as 1998 it accounted for nearly two-thirds of supply. Today production from its own mines gives it a mere 45% share. Only a contract to sell Russian stones lifts its overall market share to around 55%.

That is a painful shift, but De Beers is still the biggest diamond producer. And rival mining firms do share one big interest with it: high prices for the stones they dig from the ground. That is why, although it is under pressure, the central clearing system that sustains high prices could yet survive a bit longer. Rather than controlling a pure monopoly, De Beers might be able to run a quasi-cartel that stops the market from opening fully. De Beers says the price of rough stones is still rising; the price of polished stones has risen by 10% this year, according to polishedprices.com, an independent diamond website that tries to track such things.

Worth fighting for

The next challenge might be manageable too. De Beers's system is highly secretive. Nobody knows the ultimate source of particular diamonds it sells, as all are mixed together in London. But De Beers faced extraordinary public-relations pressure after it emerged that rebel armies in Africa were funding their wars by selling what became known as conflict diamonds.

Since 2000 almost 70 countries and all of the big industry players (under the threat of consumer boycotts and activist campaigns by, among others, a London-based group called Global Witness) have adopted standards designed to prove the origins of their diamonds. The so-called Kimberley Process is now in force: governments must issue certificates of origin for the stones they export, and the stones can then be tracked.

It was under this agreement that Congo-Brazzaville was punished last week by being expelled from the Process (the first country ever to be thus censured). As a result, legal trade in its diamonds should cease. It is a test case for the industry.

The introduction of the Process could have threatened De Beers, which wanted to maintain the right to buy diamonds anywhere it pleased and to keep its purchases secret. Eli Izhakoff of the World Diamond Council, an industry body based in New York, says the new rules mean “the industry is changing—it is nothing like it was four or five years ago.”

But although the regulations make it easier to track the flow of rough diamonds, they have not required De Beers to open all its books to public scrutiny. Most of those diamond-fuelled African wars are over. And the firm has a declining interest in buying up any rough stones that appear on the market. It knows that its ability to control world supplies is dwindling.

It is the third challenge that is much more troublesome. This is a threat to break up entirely the way De Beers organises the industry. It can best be summed up in two words: Lev Leviev.

Like the Oppenheimers, Mr Leviev has made himself very rich over the past three decades. An Israeli of Uzbek descent, he is reputedly worth around $2 billion. Though he has interests in transport and property, his real love is diamonds. His Lev Leviev Group is the world's largest cutter and polisher of them. He has mining interests too: his fleet of clanking mining ships began operating off Namibia's coast earlier this year, sucking up diamonds from the sea bed. He boasts it is the world's second-largest fleet; only De Beers has a bigger one.

And Mr Leviev recently moved into diamond retailing. He claims that he is the only tycoon with interests in every stage of production from “mine to mistress” (a canard in the industry holds that men buy more diamonds for their mistresses than for their wives). But his real power lies in the cutting and polishing businesses.

He has factories in Armenia, Ukraine, India, Israel and elsewhere. These give him power to challenge De Beers's central clearing house and seek instead to channel stones directly, and at a lower price, to his own polishers. There is a more personal explanation too. Mr Leviev long worked as one of those De Beers sightholders, buying unseen parcels of stones at non-negotiable prices. Even as recently as last year he was among De Beers's clients in South Africa. Being forced to take or leave the stones granted by the diamond cartel infuriated him. He was eager to strike back.

Mr Leviev says he is the only tycoon with interests in every stage of production from “mine to mistress”

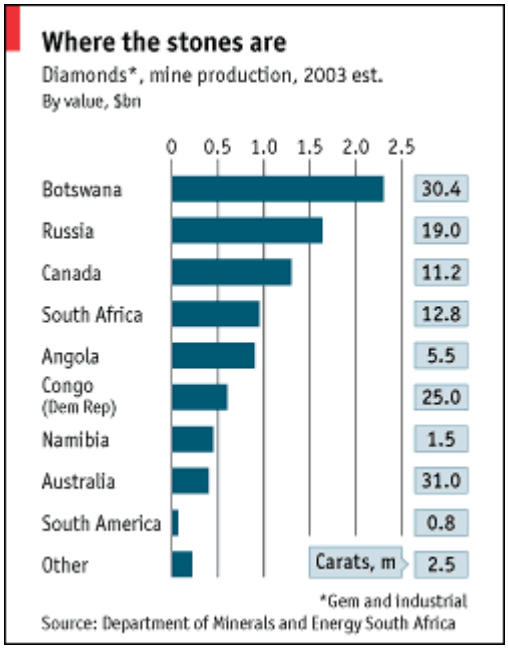
His breakthrough came in Russia. Mr Leviev has cultivated close ties with Russian politicians, including Vladimir Putin long before he became president. Already well known as a cutter and polisher of diamonds in the 1980s, Mr Leviev was asked to help the Soviet state-owned diamond firm set up local factories 15 years ago.

He agreed and formed a joint-venture with the state firm, now called Alrosa. But he insisted that stones for the factories be supplied directly from Russian mines, rather than diverted through De Beers's central system. De Beers was furious at the loss of supply, but the factories got their local stones. When the factories were privatised, Mr Leviev somehow emerged as the exclusive owner.

What happened in Russia set a pattern for clashes elsewhere. Mr Leviev has found that governments welcome factories that create jobs and add value to the diamonds they export; it is a smart way to snipe at De Beers.

Can Lev levitate?

Angola was next. Angola's diamonds are among the world's best when measured by value per carat (see chart) and promise a lucrative return for anyone who can market them. De Beers has had a long interest there. Mr Leviev first invested $60m in the country in 1996, financing a mine at a time when civil war was raging. And just as he cultivated Russia's governing elite, he struck up warm relations in Angola.



It was a well-timed move. The Angolan government despised De Beers. In the days when its monopoly was secure, De Beers regularly bought up any supply of rough diamonds that appeared on the market. It was accused of helping, indirectly, to fund UNITA, the rebel army in Angola, which sold huge quantities of diamonds. In 2001 De Beers ended a spat with the government by quitting the country. By then Mr Leviev had already moved in, eager for another supply of good stones.

By the time the government won Angola's war in 2002, thereby getting control of all the country's diamond mines, the contracts it had struck with Mr Leviev (ie, those lost by De Beers) were worth $850m a year, a sum greater even than that lost by De Beers in Russia.

Mr Leviev has not had it all his own way. Last year Angola's government abruptly cancelled three-quarters of his deal. Some observers accused Mr Leviev of using underhand means (he is close to the daughter of José Eduardo dos Santos, Angola's president) to win them in the first place. Yet, however he

did it, Mr Leviev showed in Angola that he could barge aside De Beers in a valuable area near its southern African heartland.

Mr Leviev has been inspired to take another swipe at his rival. On June 28th he took the arm of Sam Nujoma, Namibia's president, and guided him around a sparkling new diamond-polishing factory in Windhoek, Namibia's capital. “For years we have been told this could not be done,” commented various Namibian politicians.

Now Mr Leviev, saviour-like, strode around his factory, showing off row upon row of workers, who wore uniform green overalls and fiddled with chrome machines and modern flat-screen computers. Mr Leviev boasts that, with its capacity for 550 workers, the factory is Africa's biggest.

Jonathan Oppenheimer, affable heir to the Oppenheimer dynasty, says he does not understand what Mr Leviev is up to in Namibia: “And when we don't understand, we worry.” He is right to be concerned. Mr Leviev's obvious next step in Namibia is to challenge De Beers directly. De Beers's mines are run in a joint venture with the government called Namdeb. A 1999 mining law lets the government force any miner to supply stones locally. If Mr Leviev demands it, the government could tell De Beers to provide stones directly to Mr Leviev's new factory, a repeat of the Russian blow.

Clearing up

More important, if Namibia is able to establish a viable cutting and polishing industry using its own stones, then why not every other diamond-producing country too? That would seriously threaten De Beers. Mr Nujoma all but dared his neighbours to follow suit. “To our brothers and sisters of neighbouring states, Angola, Botswana, South Africa, I hope this gives you inspiration to try to imitate what we have here,” he said at the factory opening.

Mr Leviev is building another factory in Luanda, Angola, partly hoping to curry favour with the government. More important, he is offering to build a factory in Botswana, the jewel in the crown of De Beers's empire. De Beers has close ties with the Botswana government: they share a joint venture, Debswana, that exclusively mines the country's diamonds; Botswana gets a huge share of its foreign currency and a large part of its national income from diamond revenues. It is a similar arrangement to that in Namibia.

In an interview in Windhoek last month, Mr Leviev said he had offered Botswana's government a factory to employ “tens of thousands” of people, a scale vastly larger than in Namibia. A senior civil servant from Botswana toured the Windhoek factory with Mr Leviev. As Mr Oppenheimer concedes, this is a delicate time for Mr Leviev to be courting in southern Africa. De Beers is still renegotiating the terms of an 18-year lease on the Jwaneng mine, in southern Botswana, which is due to expire at the end of this month. The mine is thought to be worth $1.3 billion a year, producing stones of a quality that would have Mr Leviev salivating.

More broadly, De Beers must renegotiate the terms of all its marketing operations in Botswana and in Namibia every five years. These talks are also due. While no-one expects Mr Leviev to break up De Beers's relationships in these countries—Mr Oppenheimer is confident that the government will not do anything to risk its big revenues—his appearance on the scene puts pressure on De Beers.

The obvious step for De Beers now would be to take on Mr Leviev at his own game. In Botswana and Namibia there have been a few diamond-polishing factories backed by De Beers. But De Beers does not want to be involved in that stage of diamond production.

It is first a miner and only belatedly a retailer of diamonds. But it is blocked from the production steps in between as long as it remains the major supplier of stones to the whole industry, says Mr Oppenheimer. Buyers of its stones would suspect De Beers of holding back the best diamonds for its own manufacture and would revolt.

Nor does Mr Oppenheimer think a polishing industry is viable in many diamond-producing countries, whatever Mr Leviev says. In Namibia just a few hundred people work as polishers and cutters. There are few skilled workers, the scale of production is small and wage costs are roughly ten times that of India, which dominates the world market and where 900,000 people work as basic polishers.

Nor are small countries, such as Namibia, likely to develop the top-level skills needed for the very highest-quality stones. Those skills are concentrated in a few cities, such as Antwerp, Tel Aviv and New York. Within southern Africa, only South Africa has a long-established cutting and polishing industry, to which De Beers supplies some good-quality stones (“specials” in the language of the trade). But Mr Leviev probably does not care. A few factories may be uneconomic, but if they allow him to get hold of direct supplies of diamonds, then so be it.

A polished act

Mr Oppenheimer is worried that a more fragmented industry will not just damage De Beers, but that the whole industry might collapse. Consumers believe diamonds are valuable largely because of decades of clever marketing by De Beers and its clients. De Beers itself spent $180m on advertising last year, its clients a further $270m. That sort of spending could not be co-ordinated and sustained, he suggests, if the industry were to fragment.

That is a risk; but there are opportunities for De Beers too. As it has lost market share, the old goliath has become nimbler. No longer focusing exclusively on defending a cartel, De Beers is freer to make decisions according to commercial interest. For instance, it now buys fewer stones at uneconomic prices; profits matter more than market share. A trimmer De Beers, with a pared down list of clients, might even be able to make bigger profits than the old giant. Last year it produced healthy profits of $676m on sales of $5.5 billion.

But its decision to settle American antitrust charges laid against it in 1994 points to how much it is feeling the pressure. De Beers executives should now be free to travel to America to conduct business without fear of arrest. That should make it easier to promote De Beers LV, a hitherto disappointing partnership with the luxury-goods firm LVMH to market De Beers-branded diamonds.

That venture may prove essential for De Beers's long-term health, as more producers bet on getting a presence in profitable diamond retailing. Already rivals are moving: Canada's Ekati mine markets its stones directly to consumers; Mr Leviev's firm struck a deal in May with Bulgari, an Italian jewellery maker, to market Leviev-branded stones. De Beers's days of market dominance are clearly drawing to a close. But consumers should not get too excited just yet. Whether a duopoly or oligopoly emerges, diamond prices are not going to plummet. Mr Leviev will be among those putting a stop to that.

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Hedge funds

From alpha to omega

Jul 15th 2004
From The Economist print edition

The rush into hedge funds is pushing down returns

Get article background

A GENTLE stroll around St James's, the nice part of London in which *The Economist* is based, and Mayfair, a little to the north-west, reveals to those with an eye for such things the changing face of the world's financial-services industry. Almost every doorway, it seems, has a clutch of brass nameplates which, apart from the occasional word “capital”, reveal little about the occupation of those within.

In fact, though much of the money managed by hedge funds is in America, St James's is the international capital of the industry: within a short walk of our offices are at least 100 such funds. And the sums they manage are growing at a giddy pace—too giddy, say some.

You can see what they are driving at. Brevan Howard, a fund that was set up last year in London's docklands, moved to St James's this year. It has $4.6 billion under management, according to Hedge Fund Intelligence, a research firm. William von Mueffling, who ran a clutch of funds at Lazard, set up on his own last year. His fund, Cantillon Capital, has already attracted $4 billion. But perhaps the most dramatic grower has been Vega, based in New York and Madrid, which had $2 billion under management at the beginning of last year. It now has $12 billion.

Depending on whose figures you believe, there are 6,000-8,000 hedge funds around the world, which together manage $1 trillion or so. In the first quarter of this year, some $38 billion flowed into hedge funds, according to Tremont TASS, a research firm—over half of the total for the whole of last year. Small wonder that hedge funds, hitherto lightly regulated, should be attracting the attentions of financial-industry watchdogs (see article). Yet hedge funds still control less than 2% of all investible assets.

It used to be that most of this money came directly from rich people. Now much of it comes via private banks, which these days advise clients to invest in hedge funds as a matter of course. Increasingly, however, a lot of the money comes from pension funds and insurance companies, which once viewed hedge funds with the utmost suspicion, but after the dismal stockmarket of 2000-02, cannot now invest quickly enough. Mickey St Aldwyn of International Fund Marketing, a hedge-fund marketing company, reckons that such is the weight and momentum of institutional money flowing into the market, hedge

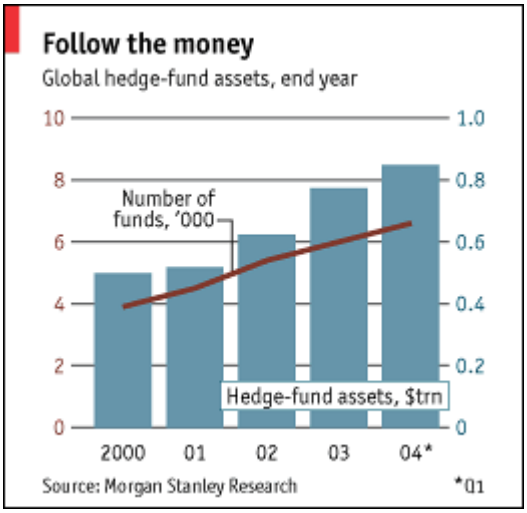
funds will be managing a colossal $3 trillion within three years.

But therein lies a problem. Traders flock to set up hedge funds because they can earn a lot: typically, funds charge a 1% management fee and 20% of profits. Good, or at least popular, managers can charge what they like. Renaissance Technologies charges a 5% management fee and takes 35% of the profits. SAC takes no fee but half the profits. But whether investors should fork out such sums is debatable: the large amounts pouring into hedge funds are driving down the returns that attracted that money in the first place.

Alpha males

Chat to just about any hedge-fund manager and he (few are women) will at some point talk of “alpha”—the extra return that active fund managers claim to earn above the market rate. The trouble is, as one manager says, “It is not a victimless crime. To make money, you have to make it from someone else.” The losers have mostly been traditional, slow institutions. “To make money you need a lot of them willing to lose 1% a year from indolence,” he says. And institutions are starting to stir.

Most hedge-fund strategies are broadly market-neutral. That is, rather than bet on a market moving one way or the other, they play the difference—arbitrage, in the argot—between markets or individual securities. Thus they buy a cheap share and sell an expensive one; or they anticipate the effect of news on the prices of an array of companies. The need for speed helps explain why hedge funds pay up to one-third of all stockbroking commissions, and account for 10-30% of trading on the London stockmarket, depending on the day.



Such strategies might make money when there are few players and lots of inefficiencies, but they are much less lucrative when there are many funds doing the same thing. Now that there are, for example, some 600 hedge funds specialising in credit (loans and corporate bonds), the inefficiencies on which they feed are much reduced, leaving the managers scratching around for other strategies or taking more risk. Generally, this means leveraging returns by borrowing more.

Nor are hedge funds the only ones pursuing these strategies. If hedge funds look like banks' trading operations, that is because they are indeed all but identical: many hedge funds started life when a bank's traders decided that they could make more working for themselves than punting the bank's capital. And lately, banks have decided that trading is such a wonderful business that they have devoted even more capital to it.

For many trading strategies, however, there is a limit to the amount of money that can be moved around cheaply and briskly. While punting large amounts on the highly liquid foreign-exchange or government-bond markets is easy, betting on illiquid corporate bonds or shares is far harder. And the larger the amounts, the more expensive the bets are.

It is for this reason that many of the oldest and best-known hedge funds will not accept any new money. Some have even been handing capital back to investors. Vega itself had told some in the industry that it did not want to grow above $2 billion, though it now clearly has more confidence in its abilities.

Whether this is justified remains to be seen. Performance in general seems to be deteriorating. In the late 1990s, says Mr St Aldwyn, no one would touch a fund that did not claim to be able to make 15% a year. Now investors seem happy with a promise of high single-digit returns.

Even this seems beyond many. In the first six months of this year, most funds were flat or slightly positive: the CSFB/Tremont investible hedge-fund index is up a touch over 1% so far this year. April and May were two of the worst months for years. Many in the industry find that disturbing, given that almost nothing nasty happened in the markets. “It's all doomed in one way or another,” says one hedge-fund manager. From alpha to omega in a few short years?

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Japan's banks

Swallow hard

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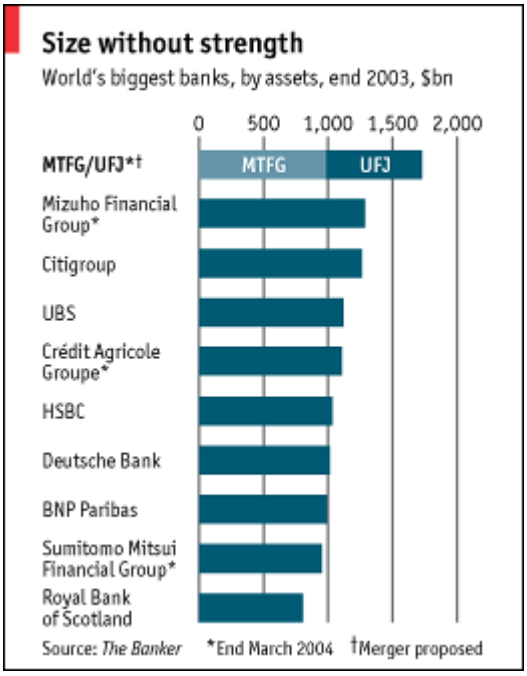
From The Economist print edition

Will a mega-merger mark the end of Japan's banking crisis?

IT WOULD create the world's biggest bank, with assets of ¥190 trillion ($1.7 trillion). More important, the proposed merger between Mitsubishi Tokyo Financial Group (MTFG) and UFJ, two of Japan's four biggest banks, would be a good thing. The couple announced on July 14th that UFJ, the smallest and weakest of the four, had proposed marriage to MTFG, which is widely considered the strongest of the bunch. MTFG is smaller than Mizuho, currently Japan's and the world's largest bank, but it is well-capitalised by Japanese standards and has a healthy corporate-lending business. Both banks' shares rose sharply on the day the news broke, even as the broader Japanese market fell.

Many past bank mergers in Japan have been products of adversity. On UFJ's side, so is this one. A few months ago UFJ, created by the union of Sanwa Bank, Tokai Bank and Toyo Trust & Banking in 2001, was forecasting that it would make money in the year to March 2004. In May it reported a loss of ¥400 billion, after the Financial Services Agency (FSA), Japan's bank regulator, forced it to reclassify many loans as non-performing. The FSA has been pressing banks to cut bad loans to half of their September 2002 levels by next April, when deposit insurance is due to be cut back. UFJ had to increase provisions to ¥1.3 trillion from a planned ¥500 billion.



The bank's top brass resigned, and the FSA ordered it to fix its internal controls and submit a plan for cutting its bad loans, which at ¥4 trillion exceed 8% of its assets. UFJ had planned to sell its trust-banking unit to Sumitomo Trust & Banking as one way to raise money, but said this week that it was scrapping that idea.

MTFG is in far better shape. It cut its non-performing loans to 2.9% of assets in March, down from 8.1% two years earlier. Its tier-one capital is 7.1% of its assets, against UFJ's 4.7% and around 6% for the other two big banks. A stronger capital base, courtesy of MTFG, should allow UFJ to write off its worst loans. Ned Akov, an analyst at ING Barings, reckons that within two to three years, given MTFG's stronger finances, the merged bank should be able to repay the ¥1.4 trillion of public money that the government has injected into UFJ in exchange for preferred shares.

What on earth, you might ask, does MTFG see in such a partner? The answer is UFJ's retail business. Although it is solid enough, by Japanese standards, in corporate lending, like all Japanese banks MTFG faces a hard time making decent returns. Corporate loan demand is weak and net interest margins are thin. To boost profits, the banks must rely at least in part on retail and small-business customers. Traditionally, big banks' job was to funnel money to companies, not to waste their time on the lowly individual customer. Now times are changing and banks are trying to build retail businesses. MTFG is still weak here, but UFJ has a large customer base. Consumer and small-business loans would account for roughly 60% of the merged bank's domestic total, about the same as at Mizuho and Sumitomo Mitsui Financial Group, the other big-four bank.

This suggests that MTFG is interested in UFJ for business reasons. There seems to be no undue pressure from regulators: Heizo Takenaka, the minister in charge of the FSA, has said that any merger decision would be entirely up to the two banks. Nor, believes Mr Akov, are the banks being lured by the perverse

incentive to get together in order to be judged as too big to fail. That marks a big shift from the 1990s. David Atkinson, an analyst at Goldman Sachs, reckons that a merger would increase the banks' combined market capitalisation by 40%.

Making the merger work will not be easy. The new bank will have to deal with UFJ's abominable collection of bad debtors. It is high time that the likes of Daiei, a retailer, Misawa Homes Holdings, a housebuilder, and Sojitz, a trading company, were cast adrift. Although MTFG, the main lender for other firms in the Mitsubishi family of companies, has better clients on the whole, there are exceptions to this general rule. For example, UFJ boasts ties to Toyota, while MTFG is saddled with the much less attractive Mitsubishi Motors Corporation, for which it helped to arrange a ¥450 billion bail-out earlier this year. The merged bank will somehow have to combine the two lists of clients, writing off the worst. Differing corporate cultures and client loyalties could make this messy.

Cleaning up bad loans is not the same as making money, however. On the revenue side, net interest margins on new loans remain pitiful, partly because demand for loans is low and the banks are so eager to lend. If Japan's economic recovery, which still looks strong, continues, growing capital investment could eventually foster a rebound in loan demand. Genuine reflation would also increase bond yields, however, partly offsetting those higher profits.

With or without a merger, Japan's banks are a long way from turning retail banking into a solution to low profitability. Less competition from the state would help, notably from the post office, the world's biggest financial institution. Nevertheless, this week's proposed merger is good news. It demonstrates, of course, the troubles of UFJ. But it also shows that the main question now facing Japan's big banks is no longer “How do we survive?” but “How can we make money?” That is surely welcome.

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Sex discrimination on Wall Street

Frustration

Jul 15th 2004 | NEW YORK
From The Economist print edition

Morgan Stanley's $54m settlement leaves important issues unaired

FACING several weeks in open court fending off allegations of sexual discrimination, Morgan Stanley took the quick way out. As it did in response to recent scandals over Wall Street research and mutual funds, it proclaimed its innocence and caved in. In a settlement reached on July 12th, Allison Schieffelin, a bond trader fired by the investment bank four years ago, will receive $12m. Another $40m will be available to those of the 340 women who worked in Ms Schieffelin's area of Morgan Stanley and can convince an arbitrator that they were wronged. Any remaining money will be used to subsidise women studying finance. A further $2m will be spent on diversity training programmes at the firm.

This messy case thus ended on the courthouse steps. It is not hard to see why settlement suited both sides. Morgan Stanley dreaded seeing tales of its traders' boorishness in the tabloids and on daytime television. Already, allegations had surfaced about an “erotic” cake, as well as about marketing trips to strip clubs and groping. Just as scary, perhaps, a trial would have revealed details of people's pay, to the glee of the firm's competitors and the ire of some of its employees. And all this even if Morgan Stanley had won.

On the other side, had the trial gone ahead, the US Equal Employment Opportunity Commission (EEOC), the federal agency that brought the case, would have had to show that discrimination was a company-wide practice—a high bar. It might also have been awkward that, in absolute terms, Ms Schieffelin was not poorly paid. In the last full year before she was fired she earned more than $1m; the only person with a similar job on her trading desk who was more highly paid was another woman.

And yet the settlement has left neither side truly vindicated. Morgan Stanley stands accused of sex discrimination and many will view its large payment as an admission, regardless of any assertions to the contrary. Ms Schieffelin and the EEOC proved only that a top Wall Street firm feared a jury trial.

This is a pity, because important details of the case were never examined. These had much less to do with suggestive confectionery and salacious stories than with promotions, pay, working conditions, privileges, slights and retaliations: the stuff of everyday life on Wall Street and in many other places besides. It does not take an expert to see that few women have made it into top positions at investment banks, but the unfairness that is most pervasive and hard to rectify, says one of those few, occurs farther down because of issues such as how clients' accounts are awarded to bankers or taken away from them, and how careers are pushed forward or held back. The Schieffelin case could have shone useful light on these more mundane, but important, cultural factors.

There will surely be more such litigation in America. London employment tribunals have lately been dealing with a rash of similar cases. Future American cases are also likely to be settled quickly and (investment banks hope) quietly. Sadly, a consequence is that no one will see exactly what was wrong. That will impede putting it right.

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Economic freedom

Liberty and investment

Jul 15th 2004
From The Economist print edition

The Fraser Institute reiterates the value of economic freedom

WHY do some countries feast, while others live with famine? Some economists explain the gap in terms of technological progress, or a lack of it. Others point to the distribution of income. Still others note the correlation between poverty and tropical climes, and ask whether energy-sapping heat and disease conspire against the accumulation of wealth. However, according to this year's “Economic Freedom of the World” report by the Fraser Institute, a liberal-minded Canadian think-tank, all these explanations are inadequate.

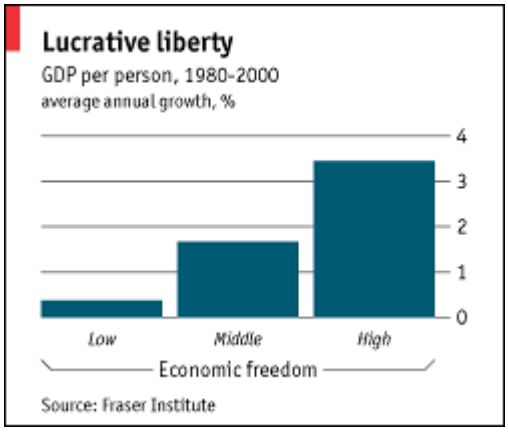
The report measures countries' promotion of “economic freedom”—defined by low taxes, protection of private property, freedom of contract, free trade and monetary stability—on a scale from zero to ten. This year's league table, which ranks 123 countries, uses data from 2002, the latest available. The usual names are at the top. Hong Kong is again reckoned to be the most economically (if not politically) free place on earth, followed by Singapore. America, Britain and New Zealand share third place. Near the bottom are some political as well as economic basket-cases: Venezuela under Hugo Chávez, junta-run Myanmar and Robert Mugabe's Zimbabwe. Keen investors in Russia will be chagrined to learn that the country ranks just above Congo-Brazzaville. (North Korea and Cuba are not included, for want of data.)

Since 1980, the average economic-freedom score has risen from 5.1 to 6.5. Sounder monetary policies (and hence low inflation) are one reason. Only 15 of the 104 countries surveyed in both years had double-digit rates of consumer-price inflation in 2002, compared with 76 in 1980. Second, governments have made their marginal tax rates less painful. In 2002, no country in the survey had a marginal personal-income-tax rate of 60% or more. In 1980, 49 countries did. And financial and foreign-exchange markets are freer. In 1980, 36 countries saw black-market exchange-rate premiums of 25% or more, a sure sign that the currency market is rigged. By 2002, only four countries suffered in this way.

Economic freedom, argues the report, does much to foster the investment poor countries urgently need if they are to grow. James Gwartney and Robert Lawson, its authors, have found that the freest 20% of countries invest around $11,000 per worker, more than 12 times the figure for the least free 20%.

The effects of economic freedom on coveted foreign direct investment (FDI) are even stronger. The freest fifth of countries attracted over $3,000 of FDI per worker, against $68 for the least free fifth. Moreover, freer countries make better use of what they have: the authors estimate that investment is 70% more productive in the most free countries than in the least free.

This translates into faster GDP growth (see chart). After adjustment for differences in initial income, climate, the proportion of people near coastlines and human capital, countries with a freedom score below five saw growth of less than 0.4% a year, on average, between 1980 and 2000. Those scoring more than seven clocked up 3.4%. Economic freedom, it seems, can take you a long way.



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Sino-American trade

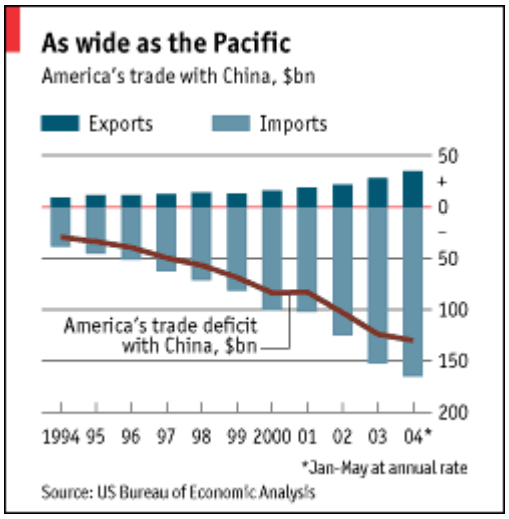
Not bashing Beijing

Jul 15th 2004 | WASHINGTON, DC
From The Economist print edition

America's trade relations with China are smooth, for now

“REAL results.” So declared a banner behind America's top trade negotiator, Bob Zoellick, when he announced on July 8th that his country had resolved a long-standing dispute with China about semiconductors. It was, he claimed, the latest in a series of Sino-American trade quarrels that the Bush administration has sorted out. This being election year, Mr Zoellick had a political message to send: while John Kerry, the Democratic presidential candidate, bangs on about “getting tough” with China, George Bush's team is getting things done.

America's trade relations with China are a sensitive political issue. China has become a convenient scapegoat for job losses in manufacturing. To some, America's rising bilateral trade deficit (see chart) is proof that the Chinese are unfair traders. With jobs (or the lack of them) a central theme in the presidential campaign, many trade analysts feared an outbreak of anti-Chinese protectionism this year.



The Democrats have lived down to expectations. Mr Kerry has lambasted the Bush administration for turning a “blind eye” to China. The semiconductor agreement, says his campaign team, is “too little, too late”. It promises harder words and more action against China. The Bush administration, however, has been determinedly cool with the Chinese, speaking softly and wielding a big stick.

This approach seems to be working. In April, a Sino-American trade commission resolved several gritty disputes, including disagreements about standards for mobile-phone technology, approvals for biotechnology products and the regulation of express-delivery firms. In particular, China gave up a plan for its own wireless encryption standard. In recent months, American and Chinese negotiators have also ironed out spats over soyabeans, America's biggest export to China, and cotton. All this without recourse to the World Trade Organisation (WTO).

The semiconductor agreement, in contrast, came after America had filed a complaint at the WTO, the first-ever against the Chinese. The Americans had long claimed that China's tax refunds for domestically produced semiconductors broke global trade rules, but the Chinese showed little inclination to remove them until the Americans went to the WTO. But rather than drag the issue through endless panels and appeals (as America itself has often done), the Chinese decided to scrap the offending rebates before the WTO machinery got into gear. Since semiconductors are America's third-biggest export to China, this was no small deal.

The Bush administration has also resisted calls to slap tariffs on Chinese products. Earlier this year, American trade unions demanded an investigation into the allegedly unfair trade advantage China gains from its “repression of workers' rights”, under a trade-law provision called Section 301. This could in theory have resulted in high tariffs. A group of manufacturers wanted similar tariffs because, they claimed, China's “manipulated currency” gave its firms an unfair advantage. The administration dismissed both.

That said, the Bush administration has protected some American industries against Chinese imports—if less eagerly than free-traders feared. Under the terms of China's accession to the WTO, other members may impose “safeguard” protection to stave off surges of imports from China. America has so far used

this rule in three instances, all in textiles. China is the biggest target of American anti-dumping duties, which cover 58 Chinese products from paintbrushes to televisions. In recent weeks anti-dumping duties were imposed on Chinese shrimp and wood furniture—although the tariffs were lower than American producers had hoped.

Plenty of problems remain. American firms are still furious about how intellectual property is treated in China. Over 90% of software is pirated and patent protection is patchy. Early this month China's patent office retroactively overturned Pfizer's patent for Viagra. Though the Chinese have promised to crack down on intellectual-property rights, for example by toughening penalties, they have a long way to go. There will also be more pressure for safeguards in the months ahead, especially when the quota system that has long ruled global textile trade is eliminated at the end of this year. Just how these challenges are dealt with will depend on who wins the election.

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Economics focus

Too many countries?

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Let a splendid new book on globalisation be the last for a while: it will not be bettered soon

GIVING the Hayek Memorial Lecture at the Institute of Economic Affairs in London this week, Martin Wolf, the chief economics commentator of the *Financial Times*, began by quoting Adam Smith:

> What is prudence in the conduct of every family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.

There you have it: the case for globalisation. The rest, you could say, is details. Unfortunately, many people remain unconvinced. What about fairness and justice, principles which everybody believes should regulate the conduct of individuals? How could today's staggering discrepancies between the richest and poorest countries ever be justified?

In his lecture, and in the marvellous new book on which it is based, Mr Wolf agrees that alleviating global poverty is the challenge of the age. And he explodes the idea that economic liberals must regard extreme inequalities as somehow justified, a sad necessity sanctified by the market. The Sudans and Somalias, he argues, do bear witness to the limits to globalisation—but only in the sense that globalisation needs to go further. The poorest countries in the world stand mostly outside the global economic system. The challenge for development policy is to connect these countries to the rest of the world.

Better than the rest

Mr Wolf's new book, “Why Globalisation Works” (published by Yale University Press), is the fullest and most sophisticated treatment to date of the case for globalisation. All the topics he addresses—the varieties of anti-globalist thinking; the forces driving and impeding economic integration; criticisms, valid and invalid, of the prevailing economic order—have been addressed elsewhere, but never before with such depth of thinking, and in one place. “Why Globalisation Works” is a long, serious book, addressed to economists and to academics in neighbouring disciplines as much as to the intelligent general reader. But Mr Wolf writes in plain, taut English, without gimmicks or condescension. His book is the definitive treatment of the subject, and an absorbing read for anybody with an appetite for moderate intellectual exertion.

One of the book's main ideas, highlighted in this week's lecture, is the interdependence of states and markets. Mr Wolf devotes a lot of attention to the vital, albeit limited, role that the state needs to play if countries are to prosper. The poorest countries are often failed states—where those crucial tasks (providing security of property and the rule of law) are left undone. Globalisation passes such countries by, condemning them to stay poor. Mr Wolf is surely right to highlight this. But what, if anything, can the outside world do to remedy the problem?

This is much the most difficult of all the questions Mr Wolf deals with. Here, even those who agree with him about everything else may now and then wish to take issue. For instance, he emphasises that the world's economic fragmentation arises from its political divisions. Lack of “jurisdictional integration” sustains bad government: in effect, there are too many countries. He notes that the European Union, a “regional system of jurisdictional integration”, served as “an extraordinarily successful machine for generating economic catch-up among previously poorer members, from Italy in the 1950s and 1960s to Ireland in the 1990s.” If only, one is invited to muse, we could do the same for Sudan.

This is almost to see jurisdictional integration as an end in its own right. The Soviet empire achieved jurisdictional integration, and the economic results were mixed, shall we say. Intense economic integration between America and Europe has been possible without jurisdictional integration. The East Asian tigers, now followed by China and India, have achieved economic integration and astoundingly rapid economic growth without “sharing sovereignty”. Convergence on good government, not on fewer governments, is plainly what the world needs. Whether jurisdictional integration serves the goal of good government rather depends.

In one way, as Mr Wolf acknowledges, it militates against it, by suppressing regulatory competition—as when states compete to attract foreign investment. It is at least arguable that, historically, Europe owes more to trade plus jurisdictional competition than to jurisdictional integration in its own right.

In thinking about what can be done to help the poorest, Mr Wolf also calls for more aid—but somewhat inconsistently. He recognises that aid can be useless, or worse than useless, in countries with bad governments, either because the money is simply wasted or else because it helps to keep corrupt rulers in place. This implies that aid (aside from emergency humanitarian assistance) should be aimed mainly at countries with relatively clean and competent governments—the ones, you might say, that need it least. Yet Mr Wolf then calls for “assistance aimed predominantly at the world's poorest and weakest states”. His reasoning? Well, he asks, what is the alternative? The West cannot just stand by.

A fine sentiment, but for once good intentions have apparently overcome Mr Wolf's instincts for logic and tight argument. An expense of resources that is useless or harmful is worse than the alternative, which is to do nothing, however dreadful that might be. Still, Mr Wolf cannot be accused of complacency, unlike some other advocates of globalisation. He sees the failings, and wants to deal with them. Unfortunately, nobody, not even Mr Wolf, has yet come up with a good answer to the question of what the world is to do about failed states.

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AIDS

The end of the beginning?

Jul 15th 2004 | BANGKOK
From The Economist print edition

EPA

Serious amounts of money are now being made available to deal with AIDS in poor countries. That is good news, but is bringing its own problems

Get article background

THE elephants said it all. Scientific conferences rarely start with a parade of elephants. But AIDS conferences are different. These days they resemble gigantic photo-opportunities as much as scientific meetings. To this end, the 15th International AIDS Conference, just held in Bangkok, was graced not only by the high-commanders of antiretroviral research (who provide the tools) and of donor governments and organisations (who provide the money), but also by Kofi Annan, Dionne Warwick, Richard Gere, Jennifer Hawkins (Miss Universe, for any readers unfamiliar with the name) and several other real or wannabe celebrities.

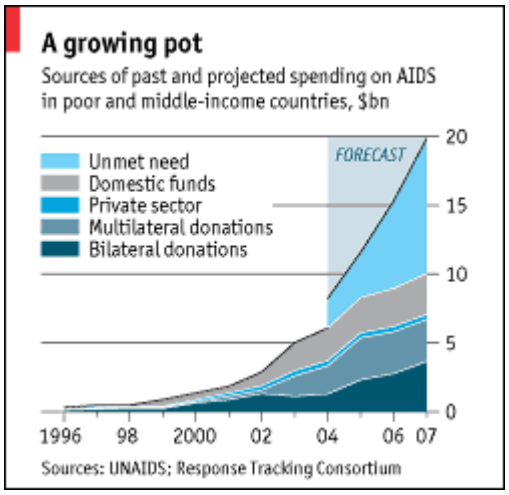
Oh, and there were some 17,000 groundlings, too: scientific worker-ants, doctors and nurses from all corners of the globe, charity workers, businessmen and bureaucrats. For AIDS conferences operate on many levels. They serve to remind the world (or, at least those parts of it not badly affected by the epidemic) that AIDS has not gone away, that it is getting worse and that action is needed. They serve to allow the groundlings to talk, to swap ideas and generally to stick their fingers in the air to see which way the wind is blowing. And they also serve as a forum for political gestures to be made—for fingers to be stuck in the air for non-meteorological reasons.

Normally, such gestures are the purview of international AIDS activists—those for whom drug companies are always wicked, politicians never sufficiently concerned, and no pot of money ever big enough. This year, though, the main political gesture came from the Americans. For, apparently in revenge for the barracking he got from activists at the 14th AIDS conference held in Barcelona two years ago, Tommy Thompson, America's secretary of health and human services (and thus the political master of that country's National Institutes of Health and its Centres for Disease Control and Prevention), decreed that only 50 scientists funded by his department might attend. That is less than a quarter of the number that went to Barcelona.

This may be a turning point, even though the *amour propre* of a single politician might be somewhat discounted. But there are other signs that the Americans are disengaging from what has hitherto been a

united international front against AIDS, in order to pursue their own agenda.

Oddly, that is a sign of the activists' success. The money for which they have been clamouring is now starting to roll in. Though it is not yet the torrent that they would like, it is, at least, a respectable and expanding stream (see chart). But he who pays the piper calls the tune, and the biggest piper-payer is the American Treasury. Unfortunately for the activists, the guardians of that Treasury now seem to want to play by their own rules.



The biggest bone of contention is PEPFAR. PEPFAR stands for the President's Emergency Plan for AIDS Relief, and the president in question is George Bush, who proposed the fund in 2003 and persuaded Congress to stump up the money.

PEPFAR is offering a total of $15 billion, of which $10 billion is new cash, over the next five years. One-fifth of the fund is to be spent on campaigns to prevent the virus from spreading, the rest on treating those already infected and looking after the bereaved—especially children. Most of the new money will be spent in 15 countries, mainly in sub-Saharan Africa, which is by far the worst affected part of the world.

The plan's aims over that period are to treat 2m people infected with human immunodeficiency virus (HIV), which causes the disease, to prevent 7m new infections, and to care for 10m HIV-infected individuals and AIDS orphans. The money is now starting to reach the field. Not everyone, however, is happy.

One reason many activists are unhappy is that Congress requires at least one-third of the prevention money to be spent on programmes that focus on sexual abstinence. Practice has shown that such an approach does not work—at least it does not work without an equal or greater emphasis on the use of condoms by those who find they cannot adopt saintly standards (see article). Condoms are included in the “ABC” (Abstain, Be faithful, use a Condom) acronym that describes this part of PEPFAR. But activists fear that the importance of condom use is being played down, for religious reasons, rather than played up, as it will need to be if PEPFAR is to achieve its objectives.

Nor are the activists pleased with the plan's arrangements on antiviral drugs, which are supposed to reach about 200,000 people by the end of this year and many more in future years. Those groups that have so far been awarded contracts under the plan have no choice but to deploy medicines approved by America's Food and Drug Administration (FDA).

That might sound reasonable, but most such drugs are branded American products. Cheaper (foreign-made) generics are not permitted without FDA say-so. That is despite the fact that many have been approved by the World Health Organisation (WHO), that they are being used in treatment programmes financed by other donors, and that they are more convenient because they combine multiple drugs into a single pill that need be popped only twice daily. Branded products, by contrast, involve taking as many as six separate pills a day.

Fast-track treatment

Unlike Mr Thompson, Randall Tobias, the president's global AIDS co-ordinator, came to Bangkok. He says he thinks it would be wrong for his country to give foreigners drugs that have not been approved as suitable for Americans. The FDA has implemented a “fast-track” review process to allow such combination pills to be bought through the plan. But many people are not convinced that the fast track will be fast enough.

Another source of unhappiness is to be found in some of the countries where the cash is being spent. While recipient governments say they are grateful for the money, local officials—in Uganda and Rwanda, for example—complain privately that they have not been adequately consulted about the plan's projects for their countries, and are worried these may not fit in with national strategies to fight the disease, though Mr Tobias says that it is PEPFAR's intention to collaborate with local health ministries.

Activists are not the only people who are critical of PEPFAR. America's Government Accountability Office

has just issued a report making similar observations, especially with regard to the way the plan is being implemented on the ground. Some of these problems will probably go away in time—though that time will cost lives. Generic drugs will get FDA approval eventually, and American officials will no doubt come to terms with other donors and local health ministries. And although the money spent on abstinence will probably be wasted, it is only one-fifteenth of the total and if its failure is manifest, then there will be pressure for change. But the American attitude of “my way or the highway” may be a symptom of a wider breakdown—a growing dissatisfaction with the way things are being done at the moment.

The weight of money is certainly having unintended consequences. American officials themselves have been complaining that they cannot cope. In June, Mr Tobias met with the embassy officials who are responsible for rolling out PEPFAR. The officials complained that the sheer speed with which the money was being pushed into the field was overloading their staff. Indeed, the amounts are so large that there are worries that it might have inflationary consequences in some of the more fragile local economies.

There is also the question of whether local health systems can handle the largesse being showered on them. Here is one small, but significant, example. ACHAP (the African Comprehensive HIV/AIDS Partnerships) is Botswana's anti-AIDS programme. It began four years ago with promises from the Bill and Melinda Gates Foundation, and the Merck Foundation, of $50m each. So far, only half of this money has been allocated, and only 70% of that has actually been spent. The system simply cannot take any more and deploy it wisely or usefully.

This is one of the facts that dare not speak its name. Botswana is an honest, well-governed and, by African standards, wealthy country. If its health system cannot absorb treatment funds effectively, serious questions need to be asked of larger efforts, such as the WHO's “3 by 5” programme to put 3m infected people on antiviral drugs by 2005. Indeed, a report that came out at the conference showed that this (admittedly ambitious) campaign is significantly behind schedule. Perhaps more needs to be spent on the unglamorous task of building new health delivery systems, and less on the actual drugs themselves.

None of which is to suggest anything other than that a lot more money will be needed in the future. The antiviral drugs now on offer are palliatives, not cures. People need to be treated for life. That requires long-term commitments in a world where political attention spans are usually short and where no government can easily bind its successors. Unless a cure is found (and none is in sight) what is actually happening is the creation of a huge population of people who are dependent on the taxpayers of the rich world. How long will they be willing to stump up? You may as well ask an elephant.

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AIDS in Asia

Ready for take off?

Jul 15th 2004 | BANGKOK
From The Economist print edition

Stopping AIDS in Asia requires bold governments and lots of condoms

Get article background

Reuters

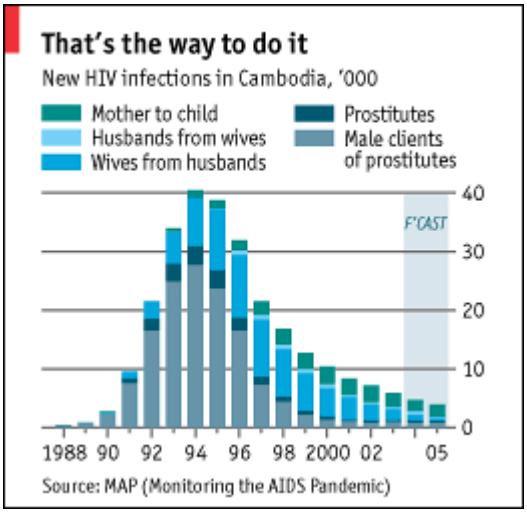
Wen Jiabao warns China

THE 15th International AIDS Conference is being held in Bangkok for two reasons. The first is that Thailand is one of the few countries that has managed to nip a potentially serious AIDS epidemic in the bud. The second, more alarmingly, is that there are growing concerns that many of its neighbours will fail to do likewise.

The received wisdom is that epidemics have two phases. In the early phase, the virus spreads rapidly among a relatively small group of high-risk individuals. Depending on the context, this group can include any or all of: prostitutes and their clients (including men whose work involves a lot of time away from home), promiscuous homosexual men (who tend to have more partners than promiscuous heterosexuals), and injecting drug users. In the late phase, some high-risk individuals will subsequently introduce the virus to the rest of the population.

On this view, several Asian countries are at risk of at least phase-one epidemics. And that would be bad enough, for some of these countries—most notably India and China—are so large that even their high-risk populations amount to many millions of people.

The question of how far the virus would spread beyond high-risk individuals is more moot. Loose talk of African-style spread, with double-digit infection rates, is now thought far-fetched. But even if only a few per cent of the population of the world's largest countries became infected, the result would be a huge increase in the overall number of AIDS victims.



Thailand's relative prosperity has certainly helped it to combat the infection. But impoverished Cambodia has succeeded, too (see chart). The chief strategies in both countries have been to discourage men from visiting prostitutes, and to persuade those who do to use condoms (mostly by encouraging the women to insist). That these governments have been able to tackle the squeamish issue of prostitution is to their credit, although they have been less forthright in addressing the equally sensitive question of injecting drug use. What they have definitively proved, says Tim Brown, one of the authors of "AIDS in Asia: Face the Facts", a report issued at the conference by MAP (Monitoring the AIDS Pandemic) is that promoting condom use works. This is an important insight, given fears that America's new anti-AIDS programme, PEPFAR, appears to be downgrading the importance of condoms (see article). According to Dr Brown, Thailand's epidemic would have been in the millions by now had the country not promoted condom use vigorously. Instead, infections are in the hundreds of thousands.

Dr Brown backs this with a mathematical model that allows him to tinker with variables such as what fraction of a country's male population visits prostitutes regularly, and what fraction of such encounters

involve condoms. This suggests that when 60% or more of paid-for acts of sexual intercourse are covered by a condom, that is enough by itself to stop an early-phase epidemic in its tracks—even without reducing the number of men visiting prostitutes. (Condom use in Thailand in these circumstances is now reported by the girls themselves to be 90%.) It also suggests that when phase two gets going, infection rates can rise sharply, levelling out at around 2% of women and 5% of men. If that happened to a country the size of China or India, it would double the number of infected people in the world by itself. Such a realisation probably motivated Wen Jiabao, China's premier, to warn his citizens on the eve of the meeting that they are at risk of a massive AIDS epidemic. Last week's United Nations report on AIDS suggested China could see 10m people infected within six years.

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AIDS microbicides

An ounce of prevention

Jul 15th 2004 | BANGKOK
From The Economist print edition

If they can be made to work, microbicides will be a powerful weapon against AIDS

Get article background

ONE of the most contentious issues in the field of AIDS is the use of condoms. Some people—including many on America's religious right—object to them because they think that contraceptives of any sort encourage promiscuity. Others—the pope and couples who want to have children—object simply because they are contraceptives. Others again object because condoms detract from the pleasure of sexual intercourse. The last two objections, though, would be rendered irrelevant if a different barrier to the entry of HIV could be found.

The next few years could see the discovery of just such a barrier, for one of the most promising ideas being discussed at the AIDS conference in Bangkok was that of vaginal microbicides.

The idea of developing an antiviral agent that a woman could put in her vagina prior to intercourse is not new. It fell out of favour four years ago when trials of what was then thought the most promising candidate, nonoxynol-9, failed to deliver. Now it is back. Two microbicides are in phase-III clinical trials (to determine efficacy) in Africa, and four others are expected to start in the next few months.

These first-generation drugs operate in one of two ways. Some work like detergents, disrupting the membrane that surrounds an individual virus in the way that washing-up liquid disrupts an oily film. The others are large, negatively charged molecules that attach themselves to viral particles (which are positively charged on the outside) and thus render them harmless. Further down the track, two more types await large-scale trials. One works by inhibiting the activity of a viral enzyme called reverse transcriptase. That stops the viruses reproducing. The other stops viruses being taken into the cells of the vaginal wall, from which they can spread to the rest of the body.

Microbicides have many advantages. They would be controlled by women, and controlled in such a way that a man would not necessarily have to know that one was being used. And, depending on which particular type of microbicide was being used, they need not have a contraceptive effect. That means that if only one individual in a partnership was infected, the couple would be able to have children without risking an infection in the other.

Microbicides, of course, will never provide the long-term protection afforded by a vaccine—should one ever be developed. But they are likely to be available for use far sooner. Zeda Rosenberg, the head of the International Partnership for Microbicides, a charity based near Washington, DC, says that if any of the six phase-III trials were to come up trumps, a product could be on the market within five years. Unfortunately, a vaccine is nothing like that close to delivery.

Microbicides also offer another benefit. Like a vaccine they offer a public good as well as a private one in that they curb the rate of viral transmission. Mathematical modelling suggests that if microbicides were used by only 20% of women at risk, and were used only half the time, this would still prevent more than 2.5m infections over three years.

The first microbicides may prove a little awkward to use, since they would come in the form of gels or foaming pessaries that would need to be applied not more than a few hours before a sexual encounter. But Dr Rosenberg believes that at least some of the substances being considered as microbicides could be packaged into slow-release rings that a woman could wear in her vagina for a month or more. If she is right, what was once seen as an orphan technology could emerge as one of the most hopeful developments in the field of AIDS for almost a decade.

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New fiction

Flights of imagination for an unforgettable vacation

Jul 15th 2004
From The Economist print edition

This week we devote the whole of the section to reviews of novels that could make great travelling companions

JUST over 40 years ago, Greek and Turkish book-lovers alike burst into tears as they read a new Greek novel: in “Farewell Anatolia”, Dido Sotiriou drew on her childhood memories to describe the comradeship of two shepherd boys, one Christian, the other Muslim, who go on to fight on opposite sides of the Greek-Turkish war of 1919-22. On the final page, the Christian narrator mourns his native soil and his long-lost friend—and curses the powers that divided them.

Until now, the human story of Ottoman society's violent break-up, under the pressures of war and nationalism, has largely been kept within the Greek-Turkish family: not many people outside the region know it, and even there it must be told elliptically because it flies in the face of nationalist orthodoxies. Now a version of this story will reach a wider audience: it is the theme of a new novel—his first for a decade—by Louis de Bernières, the British author who captivated readers with “Captain Corelli's Mandolin”, a tale of love and war in Greece.

Birds Without Wings
By Louis de Bernières

To be published in America by Knopf in August; $25.95
Secker & Warburg; 625 pages; £17.99.

Buy it at
Amazon.com
Amazon.co.uk

“Birds Without Wings” is not just about one friendship, although the camaraderie of two boys later divided by war is one central theme. The book depicts a whole tapestry of relationships in a close-knit but brutish community in the twilight of Ottoman Anatolia, where Muslims pray in Arabic and Christians in Greek, but the only language anyone understands is Turkish. There is a gang of Christian and Muslim children who play together and dream of marrying. Even more impressively, the Muslim hodja's wife and the Christian priest's wife are best friends, and their husbands get along well too.

But as the war clouds gather and finally burst, the Muslim boys are taken off to hell-holes like Gallipoli, the Armenians are marched away to exile or death, and the Greek Orthodox are press-ganged into forced-labour units. After the war, the surviving Orthodox Christians are shipped off to Greece, an alien world.

As a (broadly successful) storytelling technique, Mr de Bernières presents a series of first-person accounts by village characters, in a quirky, uneven style: sometimes naive and homely; sometimes over-

elaborate. The net effect is to give the impression of a text translated from another language. Also interwoven, for historical context, is a biography of Mustafa Kemal Ataturk, founder of the mono-ethnic Turkish republic which replaced the multi-ethnic Ottoman world.

Given that his book is presented as a sort of history lesson, Mr de Bernières will be challenged on his facts. How will he fare? His account of a Turcophone world, where barriers between the monotheisms had blurred, is not entirely implausible—even though the areas where this situation existed were about 400 miles to the east of this book's notional setting. The author was inspired by the deserted ruins of a once prosperous coastal town known as Kaya in Turkish and Livisi in Greek. This is certainly a haunting, and perhaps indeed a haunted place; but virtually all its people spoke Greek and knew they were not Turks or Muslims.

Still, such quibbling should not spoil the pleasure of those who come looking for an absorbing read about a remote but captivating time. The Ottoman world's break-up is a rich, poignant story, and Mr de Bernières is a good storyteller. At times he is nearly as good as Dido Sotiriou.

Also in this section

Reviews of books by Enrique Vila-Matas, David Lodge, Colm Toibin, Katherine Bucknell, Samia Serageldin, Amitav Ghosh, Carl Hiaasen, Karen Joy Fowler and Ward Just.

Birds Without Wings.
By Louis de Bernières.
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Secker & Warburg; 625 pages; £17.99.

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New fiction

Writers' block busters

Jul 15th 2004
From The Economist print edition

THE prize-winning novels of Enrique Vila-Matas have been translated from the author's native Spanish into a dozen or so languages, but “Bartleby & Co” is the first to be published in English. It has a distinctly continental feel about it—in that it is not a conventional novel at all but a learned essay, which playfully mixes fact and fiction to explore some of the reasons why so many writers fail to write.

Mr Vila-Matas takes his title from Herman Melville's short story “Bartleby the Scrivener”. Melville, who wrote “Moby Dick” when he was 32 and not much else thereafter, knew a thing or two about not writing. His Bartleby is a deeply anti-social scrivener—an office copyist in the pre-photocopier age—who, when asked to do anything, politely declines, saying he “would prefer not to”.

Similarly, Mr Vila-Matas's narrator, Marcelo, is a reclusive office drudge. As a young man he published a novel about “the impossibility of love”, but 25 years have passed since then without a follow-up. Lately, however, Marcelo has become fascinated by the seemingly endless variety of ways in which writers manage to avoid putting pen to paper. So he decides to begin a notebook in which he will record those Bartlebys who, like himself, have managed either to put off writing for an unusually long time or never to have written anything at all.

Bartleby & Co.
By Enrique Vila-Matas
Translated by Jonathan Dunne

To be published in America by New Directions Publishing in December; $21.95
Harvill Press; 178 pages; £12.

Buy it at
Amazon.com
Amazon.co.uk

For most writers, of course, not writing is nothing more than a matter of failed inspiration, distraction or laziness. But Marcelo is not interested in such garden-variety Bartlebys. He is intrigued by the possibility that a writer's silence may be a deliberate choice with a serious aesthetic or moral dimension to it. He cites, for instance, Oscar Wilde's notion that “to do nothing at all is the most difficult thing in the world”. Marcelo wonders too whether reading well, rather than writing, might be considered a quasi-creative act.

Pathological ditherers and nerdish spotters of allusions will love this clever, slightly precious book. There is something here for everyone who enjoys fiction and has thought a little about the creative process. Mr Vila-Matas shows that the reasons for (and the consequences of) not writing fiction can, in a funny way, be almost as rich and complicated as fiction itself.

... Next article

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By Enrique Vila-Matas.
Translated by Jonathan Dunne. To be published in America by New Directions Publishing in December ($21.95)
Harvill Press; 178 pages; £12.

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New fiction

Henry James on the couch

Jul 15th 2004
From The Economist print edition

HENRY JAMES is an unexpected star of this season's fiction. First he had a walk-on part as a philosophical guide in Alan Hollinghurst's “The Line of Beauty”, already a popular summer novel in Britain. Then David Lodge and Colm Toibin turned him into the granite centrepiece of their latest novels, “Author, Author” and “The Master”. Producers of popular films based on James's fiction were never able to arouse such interest in the 19th-century New Englander.

Taking a literary lion and setting him up among friends, rivals and would-be lovers produces a queer concoction that is part fiction, part memoir and part ventriloquism. Only the most talented of writers can keep such work from sliding into lazy biography or mere pastiche.

Mr Lodge has produced an account of James's life, tearing it down into three separate acts: apprenticeship; a middle stage when James felt unable to galvanise his literary career; and the period when his recovery from a disastrous foray into the theatre led to his late, great flowering with the publication of “The Wings of a Dove” and “The Ambassadors”. Mr Lodge focuses in large part on James's rivalry with his great friend George du Maurier whose second novel, “Trilby”, became a worldwide bestseller when James's works were merely trickling out of those shops that were brave enough to stock them.

Mr Toibin's book is radically different and by far the more interesting of the two. By insinuating himself under James's skin and writing in the first person, he covers not only the known episodes of James's life, but also the darker corners of the writer's loneliness and uncertainty.

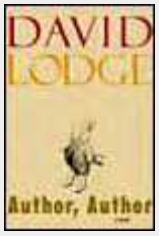
With a subject whose sexuality was never made explicit, Mr Toibin's approach offers infinite possibilities. Will James reach out and touch the back of his vigorously heterosexual childhood friend, Oliver Wendell Holmes, on the only occasion they are forced to share a bed for the night? Mr Toibin's deftness and sensitivity in teasing out the moments in James's life where might-be slides into might-have-been are particularly memorable.

The author also helps to cast new light on James's decision, conscious or otherwise, to eschew marriage and lovers in order to safeguard his art and the quiet he needed to be a writer. How else could he have become such a chronicler whose greatest work is still studied as the precursor of the modern psychological novel?

Mr Toibin and Mr Lodge are not close, though they have remained on genial terms since they first met in 1993. On that occasion, they discussed Jamesian marginalia. Nevertheless, Mr Lodge writes in his afterword to “Author, Author” that he learnt of Mr Toibin's novel only when he had finished his own. That's as maybe. If you have space to pack only one of these books, be sure it is Mr Toibin's.

Author, Author.
By David Lodge.
To be published in America by Viking Books in October ($24.95).
To be published in Britain by Secker & Warburg in September (£16.99).

Author, Author
By David Lodge



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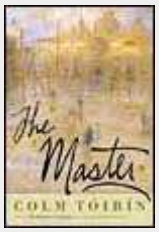
The Master
By Colm Toibin



Scribner; 352 pages; $25.
Picador; £15.99.

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The Master.
By Colm Toibin.
Scribner; 352 pages; $25.
Picador; £15.99.

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New fiction

Just a twist of lemon

Jul 15th 2004
From The Economist print edition

A SMALL but scarcely mentioned detail in the recent case of a Goldman Sachs secretary sentenced to seven years' imprisonment for stealing from her bosses is that it took one of them months to realise that around $6m was missing from his bank account. The heroes of “Canarino”—David, an American investment banker working in London, and his beautiful, refined wife, Elizabeth—live in such a world.

Canarino
By Katherine Bucknell

Fourth Estate; 341 pages; £15

Buy it at
Amazon.co.uk

One sultry summer night, David finds himself alone in his Belgravia mansion but for the dog and one of the Filipina maids. Elizabeth has decamped to Virginia with the furniture and the children to plan for a future when she can no longer count on physical beauty to solve all her problems. The telephone rings. It is Leon, David's best friend from Princeton, who has been living in London for more than a year. David is astonished to discover that the many messages Leon has left for him have never been passed on.

Leon's phone call sets in motion a series of events that show David how, rather than being protected from the fears and anxieties of his daily existence by a prestigious City job, multiple maids and secretaries, and a peerless spouse, he has placed himself in a moneyed cocoon as insulating as a padded cell.

The author, Katherine Bucknell, also the beautiful wife of an American investment banker living in London, has spent most of her life in the academic realms of literature and is the editor of Christopher Isherwood's diaries. But she takes to dissecting the lives of David and Elizabeth as a Holland Park princess to a pair of Jimmy Choo shoes. Her prose is crisp and her characters wry. The analysis of a marriage on the brink is as cruel as it is well observed. As for canarino, that fashionable twist of lemon peel lightly crushed in boiling water is the ultimate after-dinner *digestif*, the drink that, according to one character in the novel, says: “Stay like this. This is perfect. This is enough.” It is a lesson David and Elizabeth learn the hard way.

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Canarino.
By Katherine Bucknell.
Fourth Estate; 341 pages; £15

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New fiction

The pashas' passing

Jul 15th 2004
From The Economist print edition

SAMIA SERAGELDIN'S novel was first published four years ago by a small university press in America. It is now being brought out in Britain by an imprint of HarperCollins, a multinational publisher. An enchanting novel-as-memoir, it fully deserves this crack at a wider audience.

Gigi, a modern Egyptian woman born to a patrician family, grows up in the 1950s in a sprawling, multilingual house in Cairo. There is a statue to Poseidon in the garden and the cook ritually slaughters sheep for the “Feast of the Sacrifice”. No one in the house ends a sentence in the same language in which it began.

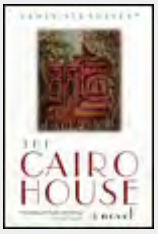
The men of the family, led by Seif-el-Islam Pasha, a patriarch who smells of Cuban cigars and Old Spice, are involved in cotton, trading and politics; the women, in shopping, gossiping and arranging marriages. For all their frippery, their traditions reinforce the ties that bind.

But the pashas' hour is passing. With the takeover of power by Nasser, with his rhetoric, his sequestration decrees and his insistence that Arab socialism be taught in schools, many of them go into exile. Those who remain maintain the traditions, but increasingly these serve only to mask the growing uncertainty and confusion.

There is nothing new in the passing of another *haute bourgeoisie*. What strengthens Ms Serageldin's book is Gigi's own personal story. Barely out of her teens, she is propelled into an arranged marriage that is sealed with a contract negotiated (in her absence) by the men in her family to show, one of them explains, that “in this marriage [your husband] is not dealing with a friendless girl, he is dealing with the men in her family, and is accountable to them.”

But Gigi's expectations are greater than those of more old-fashioned women. The marriage breaks down and she loses custody of her only son. A second marriage, to a French journalist, and their relocation to Connecticut rarely fill the emptiness she feels. Indeed, they serve only to underscore the wider point of Ms Serageldin's story: that while regimes may change and houses be bought and sold, exile is something you carry with you in your heart.

The Cairo House
By Samia Serageldin



Syracuse University Press; 248 pages; $19.95.
Fourth Estate; £15.

Buy it at
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The Cairo House.
By Samia Serageldin.
Syracuse University Press; 248 pages; $19.95.
Fourth Estate; £15.

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New fiction

Ebbs and floods on the Ganges

Jul 15th 2004
From The Economist print edition

LIKE its setting, the mouth of the Ganges, this is a sprawling, sluggish and intricate book, tinged with a melancholic and fragile beauty. Far more than any of its characters, it is its sense of place that dominates the novel—and what an extraordinary place it is. The Sundarbans, the “tide country” as locals say, are the immense shoal of islands that make up the Ganges delta, ranging from tiny sandbars to great reefs. Twice a day, all but the loftiest are swallowed up by the tide, leaving only the tips of their mangrove trees above water.

The Hungry Tide
By Amitav Ghosh

HarperCollins; 403 pages; £17.99

Buy it at
Amazon.co.uk

Life here is precarious: not just because unreliable embankments hold the tide back from the inhabited places, but also because of the tigers and crocodiles that stalk them. Moreover, mirroring this geographical uncertainty is a political ambivalence. The boundary between India and Bangladesh, established at the partition of the sub-continent in 1947, runs straight through the Sundarbans. Connected by his upbringing to both Kolkata, in India, and Dhaka, the capital of Bangladesh, Amitav Ghosh is well placed to explore these complexities, which form the background to most of his earlier work, and which occupy much of the second half of this one.

Anyone expecting a novel on the epic scale of Mr Ghosh's “The Glass Palace”, which swept across a century and a full panoply of kings, queens and empire, may be disappointed. This is a more narrowly-focused affair, and it moves more slowly: Mr Ghosh spends the whole of the first half (“The Ebb”) merely preparing for the personal and political dramas that will break in the second (“The Flood”).

But the story stealthily draws you in. Into the lives of the Sundarban islanders come, separately, two outsiders: Kanai Dutt, an urbane middle-aged but single man from Delhi, and Piya Roy, a beautiful young dolphin-watcher from America. Though both are Indian, the ways and indeed the language of the islanders are opaque to them, and the book tells the story of their deepening involvement with their surroundings, and with each other.

What makes the book so rewarding is not so much the story as the observations within it. Thus there is a moment when Piya, while taking depth readings and guided by her hugely expensive GPS navigation system, realises that the crab fisherman working with her is achieving exactly the same result with a line weighted with bits of broken tile and shark-bone.

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The Hungry Tide.
By Amitav Ghosh.
HarperCollins; 403 pages; £17.99

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New fiction

Skin deep

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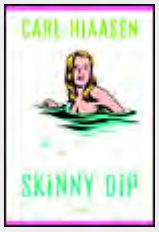
From The Economist print edition

CARL HIAASEN'S satirical romps are often underpinned by fierce environmental concerns fostered by a passion for his native Florida. Nevertheless, humour has always taken precedence over polemic in hilarious misadventures such as his take-off of the cosmetic-surgery industry, “Skin Tight”.

Yet in “Skinny Dip” an insidious preachiness gets the better of the jokes. The book's feckless villain Chaz is a biologist who doesn't recycle. Bribed by an agribusiness tycoon, Chaz fakes low phosphorus readings in Everglades water that he is testing for destructive fertiliser run-off. Fearful that his wife has discovered the scam, he throws her overboard on an anniversary cruise. Unbeknownst to Chaz, however, she survives by clinging to a bale of floating cannabis. Thereafter she plots to get even—although after so much build-up, her revenge is disappointingly inelegant.

Skinny Dip
By Carl Hiaasen



Knopf; 368 pages; $24.95. To be published in Britain by Bantam Press in October; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Most of Mr Hiaasen's larger plots are merely scaffolding on which to hang set-pieces of lacerating comedy. And one subplot here does work a treat, about an agribusiness goon named Tool who has a bullet lodged in his backside, driving him to trawl nursing homes for glaze-eyed geriatrics from whom he can strip painkiller skin patches. But even Tool is obliged to service the author's politics: after spotting a Jamaican nurse with a nice smile, he resolves never to abuse illegal immigrants again.

In addition to being poorly paced—the novel is too long for its skimpy premise—“Skinny Dip” has an earnestness problem. The good guys are ever cheerful, never hurt anyone beyond the odd pinch of the testicles, and plan to leave all their assets to the World Wildlife Mission. They don't even get drunk. The texture of the novel recalls the vogue in children's books for worthy lessons in why we must eat our vegetables, pick up our toys and understand that other races are just like us. Kids can't bear those books. And even if they do recycle, adults are not that keen on them either.

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By Carl Hiaasen.
Knopf; 368 pages; $24.95.
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New fiction

Of a different persuasion

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IT IS an enticing formula: six characters get together on six occasions to discuss the six novels of Jane Austen. As happens with such groups, they end up spending as much time learning about themselves as they do discussing the works of the gentle Hampshire genius.

Karen Joy Fowler's Californian book-club members are a colourful bunch; they include a half-Mexican woman whose husband of 32 years has just left her, their lesbian daughter, and (the only man) an out-of-work bachelor with limited computer skills. Given their background, they discuss Austen at a remarkably sophisticated level. “Structurally that confession bookends the long story Brandon tells her,” says the lesbian of a stretch of “Sense and Sensibility”: after reading only two of the novels, the computer geek is ready to suggest that “Austen's minor characters are [as] good as Dickens's”.

Interspersed with this high-level literary discussion is a staccato sequence of times remembered. Some of these are amusing enough in themselves—the lesbian leaves her writer-lover when she finds that intimate moments of her life are being recycled as fiction; what really upsets her, though, is that publishers are actually rejecting the fiction. But these episodes struggle to hold together as a plot.

The Jane Austen Book Club
By Karen Joy Fowler

Putnam/Marian Wood; 288 pages; $23.95.
To be published in Britain by Viking in October; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Ms Fowler writes with considerable wit—not just in the many allusions to Austen's work that may be apparent only to true Janeites, but also more directly. A character recalls a day-time soap opera: “Such goings-on in the small town of Denison! Murder, incarceration, drink, and despair. Adultery and hysterical blindness. Thrombosis. Throat cancer. Crippling accidents. Forged wills. And then came episode two.” The novel has its moments. But at other times it feels light enough to be tossed away by the slightest distraction.

Published in America in May to enthusiastic reviews, the book is already high on bestseller lists there. It is “essential to reintroduce Austen into your life regularly,” says one of its characters. Despite the evident success of “The Jane Austen Book Club” at doing just that, there remains no better way than to pack “Emma” or “Persuasion” into your holiday bag.

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Putnam/Marian Wood; 288 pages; $23.95. To be published in Britain by Viking in October (£12.99)

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New fiction

A time for dancing shoes

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From The Economist print edition

A GOOD coming-of-age novel is innocence recalled in maturity, yet too often the wrenching naiveté of youth is examined from the wise old age of 25. By contrast, Ward Just's 14th novel, about a 19-year-old, Wilson Raven, benefits from the perspective of an author in his 60s.

Set in 1950s Chicago during a single summer, “An Unfinished Season” recounts the story of the owner of a printing company, the narrator's father, who is on the management side of a vicious union dispute and begins to carry a gun. Wilson, his son, takes a summer job at a scandal rag, where no amount of ink on his sleeves lives down the day he arrives at work wearing his bowed dancing shoes from debutante balls on the ritzy North Shore.

What sets Mr Just's work apart is its prose. His writing is old-fashioned in the finest sense—graceful, articulate, full but not fussy. Since good writing cannot be separated from good thinking, “An Unfinished Season” is also peppered with insights: “Win the girl, win the lottery, win the golf match, win the strike; and always there was something left over, a residue you did not count on or even imagine. Winning was never the only thing; often, it wasn't anything.”

Wilson's portrait of his father is especially rich and rounded. The weakest section of the novel is the narrator's romance with the daughter of an enigmatic psychiatrist. His attempt to unravel what it is exactly that scotches the budding romance is less than satisfying. Yet never getting a proper explanation of what goes wrong in matters of the heart is a standard frustration. For Wilson, leaving the question unanswered may constitute one more introduction to adulthood.

An Unfinished Season.
By Ward Just.
Houghton Mifflin; 256 pages; $24

An Unfinished Season
By Ward Just

Houghton Mifflin; 256 pages; $24

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Obituary

Paul Klebnikov

Jul 15th 2004
From The Economist print edition

AP

Paul Klebnikov, American journalist, died in Moscow on July 9th, aged 41

PAUL KLEBNIKOV thought that Russia had changed, that grievances there were no longer pursued by recourse to contract killings and that investigative journalists therefore had no cause to fear for their safety. Even as he lay dying last Friday, he could name no one who might have given the order to the gunmen who had just fired a volley of shots at him as he left his Moscow office. Even so, plenty of Russians had reason to dislike, or fear, him.

Mr Klebnikov had always been something of a daredevil. As a small child, he would never refuse a mission, no matter how foolhardy, from an older brother or sister. He enjoyed swimming in hurricanes, and particularly liked to bring in the new year with a dip in the sea off Long Island. Yet the man of action was also reflective. Indeed, he was an idealist, who revelled in political discussion.

If the combination sounds Russian, no wonder: Mr Klebnikov, though born and brought up in America, came from a family of Russian émigrés with a long military tradition on both sides, and a bit of a political one too. His mother's grandfather had been an admiral in the White Russian fleet—he was assassinated by Bolsheviks during the revolution in 1917—and his father's forebears included at least two generals. The main political inheritance came from a great-great-great-grandfather, Ivan Pouschine, who was exiled to Siberia for his role in the Decembrist uprising against Tsar Nicholas I in 1825. All this helps to explain Mr Klebnikov's general interest in Russia, his choice of Pyotr Stolypin, the reformist Russian prime minister murdered in 1911, as the subject of his doctoral thesis at the London School of Economics, and his subsequent decision to go to work as a journalist in the land of his forebears.

Journalism was a natural choice for someone with interests as wide as Mr Klebnikov's: it allowed him to write and talk about everything from philosophy to, recently, architecture and urban design. But most of his work involved politics and business, and he was especially good at probing the murky world of post-Soviet Russia where these two intersected and where, in a few months in 1995, a few men managed to grab privatised assets on a scale hitherto unimaginable anywhere.

One such was Boris Berezovsky, about whom Mr Klebnikov wrote an article for *Forbes*, the American magazine for which he had reported since 1989, entitled “Godfather of the Kremlin: Boris Berezovsky and the Looting of Russia”. Mr Berezovsky was the richest of the seven “oligarchs” who, according to the (no doubt exaggerated) boast of one of them, controlled about half the Russian economy in the second half of the 1990s. They were known as oligarchs not just because they were few in number but because they were assumed to be, if not actually rulers themselves, at least close to those who were. Mr Berezovsky,

for instance, had a senior post in the Security Council. He did not care for Mr Klebnikov's article. Indeed, he took *Forbes* to court in London in a case that was settled only last year. By that time, though, Mr Klebnikov had published an entire book about the plutocracy and Mr Berezovsky was living in self-imposed exile in Britain.

Capitalist tools

For in 2000 the oligarchs' fortunes had changed: Vladimir Putin had become president with the declared intention of bringing them to heel, an objective that has proved hugely popular among Russian voters in subsequent elections. Yet Mr Putin's hostility to tycoons has not made him a friend to the media, which he seems to see merely as the instrument of his political opponents. NTV, the last national television station to show any independence of spirit, has in effect been taken over by the state. Its programme “Freedom of Speech”, the only balanced political talk-show on Russian television, was given its final airing a few hours before Mr Klebnikov's killing. Neither has Russia become safer for journalists: 15 have now been killed since 2000. No one has been brought to book for any of their murders.

Though several oligarchs have fled Russia or, like Mikhail Khodorkovsky, face trial there, others remain at large and indeed prosper. In May, in the second issue of *Forbes*'s Russian edition, which he edited, Mr Klebnikov published a list of Russia's 100 richest people, adding that Moscow had more billionaires (36) than any other city. Some of them could have done without the publicity. So, too, perhaps, could some of the people that Mr Klebnikov had written about in other contexts: an investigative tale in the April edition may well have caused annoyance in the Kremlin. Some of his sources, perhaps current or past members of the security services, may have thought Mr Klebnikov knew too much. Some of the people he may have planned to write about could also have been worried. And Mr Klebnikov's final book, “A Conversation with the Barbarian”, in which he made a passionate appeal to Europeans to defend Christian civilisation against Islamic extremism, can have earned him no friends in Chechnya.

In short, the array of possible suspects in Mr Klebnikov's murder is long, reflecting not just the range of his inquiring mind but also the extent of greed, theft and violence in a society still groping for an accommodation between capitalism and the rule of law. His death is Russia's loss.

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Overview

Jul 15th 2004
From The Economist print edition

America's trade deficit narrowed unexpectedly in May, in a welcome respite from recent record highs. The trade deficit fell to $51 billion, thanks to surging exports, which grew by 4.2% during the month.

Canada's trade surplus fell to $3.8 billion in May, helped by record imports. The unemployment rate rose to 7.3% in June from 7.2% in May.

Inflation figures from the **euro area** were mixed. Consumer-price inflation fell to 2.4% in the 12 months to June in **France**, down from 2.6% in the year to May. **Spain's** 12-month inflation rate, which is already the highest in the euro area, rose to 3.5% in June, from 3.4% in May.

Euro-area industrial activity remains sluggish. **French** industrial output rose by just 0.2% in May, and by 3.4% in the year to May. In the same month, **Italian** industrial output was unchanged, and grew by an unimpressive 2.7% in the 12 months to May.

Japan's industrial-output growth in May was revised upward to 0.8% from 0.5% in an earlier reading.

Britain's CPI rose by 1.6% in the year to June, up from 1.5% in the year to May, the highest inflation rate in over a year. Even so, consumer prices in June fell by 0.1%, thanks mostly to lower prices for second-hand cars and food.

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Output, demand and jobs

Jul 15th 2004
From The Economist print edition

% change on year ago

	GDP latest	GDP qtr*	The Economist poll GDP forecasts 2004	The Economist poll GDP forecasts 2005	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	Unemployment % rate year ago
Australia	+ 3.2 Q1	+ 0.9	+ 3.5	+ 3.4	– 1.1 Q1	+ 7.7 Q1	5.6 Jun	6.1
Austria	+ 0.5 Q1	+ 0.8	+ 1.6	+ 2.1	+ 5.6 Apr	+ 2.6 Apr	4.2 Jun	4.4
Belgium	+ 2.0 Q1	+ 3.0	+ 2.2	+ 2.1	– 1.0 Apr	+ 0.9 Apr	12.4 Jun†	11.6
Britain	+ 3.4 Q1	+ 2.9	+ 3.2	+ 2.7	+ 1.3 May	+ 7.4 May	4.7 May††	5.0
Canada	+ 1.6 Q1	+ 2.4	+ 3.0	+ 3.4	+ 2.8 Apr	+ 4.9 Mar	7.3 Jun	7.7
Denmark	+ 1.4 Q1	+ 3.8	+ 1.9	+ 2.2	+ 1.7 May	+ 1.5 May	6.5 May	6.0
France	+ 1.7 Q1	+ 3.1	+ 2.2	+ 2.2	+ 3.4 May	– 1.1 May	9.8 May	9.7
Germany	+ 1.5 Q1	+ 1.8	+ 1.4	+ 1.7	+ 4.2 May	– 2.3 May	10.5 Jun§	10.6
Italy	+ 0.8 Q1	+ 1.8	+ 1.2	+ 1.8	+ 2.7 May	– 1.6 Apr	8.5 Jan	8.9
Japan	+ 5.6 Q1	+ 6.1	+ 4.4	+ 2.2	+ 4.6 May	– 2.4 May	4.6 May	5.4
Netherlands	+ 0.9 Q1	+ 2.8	+ 1.3	+ 1.8	– 0.8 May	– 1.7 Apr‡	6.4 Jun**	5.3
Spain	+ 2.8 Q1	+ 2.6	+ 2.8	+ 2.8	+ 2.9 May	+ 1.2 May	11.1 May	11.3
Sweden	+ 2.6 Q1	+ 2.6	+ 2.8	+ 2.5	+ 7.5 May	+ 5.4 May	5.3 May†	4.2
Switzerland	+ 1.5 Q1	+ 1.6	+ 1.9	+ 2.0	+ 4.5 Q1	– 3.5 May	3.7 Jun†	3.6
United States	+ 4.8 Q1	+ 3.9	+ 4.6	+ 3.6	+ 6.3 May	+ 7.3 May	5.6 Jun	6.3
Euro area	+ 1.3 Q1	+ 2.3	+ 1.8	+ 2.0	+ 1.7 Apr	– 0.9 May	9.0 May	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 2.7 Q1	+ 3.0	na	na	+ 7.2 May	+ 5.7 Apr	11.6 May†	11.4
Greece	+ 4.0 Q1	+ 3.0	na	na	+ 0.3 May	+ 5.6 Apr	na	na
Iceland	+ 4.9 Q1	na	na	na	na	na	3.3 May†	3.6
Ireland	+ 6.1 Q1	na	na	na	– 0.2 May	+ 2.5 Apr	4.3 Jun	4.7
Luxembourg	+ 2.12003	na	na	na	– 1.2 Dec	+ 0.3 Feb	4.0 May	3.6
New Zealand	+ 4.4 Q1	+ 8.1	na	na	+ 5.5 Q1	+ 8.0 Q1	4.3 Q1	4.9
Norway	+ 2.9 Q1	+ 3.9	na	na	+ 5.5 May	+ 1.2 May	4.5 Q1	4.4
Portugal	+ 0.1 Q1	+ 2.4	na	na	– 1.8 May	+ 0.5 May	6.4 Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Mar-May; claimant count rate 2.7% in Jun. §EU harmonised rate 9.8% in Jun. **Apr-Jun.

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Prices and wages

Jul 15th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.5	+ 2.6	– 1.1	Q1	+ 3.0	+ 5.1	Q1	+ 4.4
Austria	+ 2.1	May	+ 1.1	+ 1.6	+ 1.5	+ 5.9	Jun	+ 1.7	+ 2.1	May	+ 2.1
Belgium	+ 2.3	Jun	+ 1.6	+ 1.7	+ 1.5	+ 3.9	May	– 0.4	+ 2.3	Apr	+ 1.7
Britain	+ 1.6	Jun*	+ 1.1	+ 1.5	+ 1.9	+ 2.6	Jun	+ 1.1	+ 4.3	May†	+ 3.2
Canada	+ 2.5	May	+ 2.9	+ 1.9	+ 2.1	+ 5.5	May	– 1.9	+ 4.0	Apr	+ 1.9
Denmark	+ 1.1	Jun	+ 2.2	+ 1.3	+ 1.9	+ 2.8	May	– 0.6	+ 3.3	Q1	+ 3.9
France	+ 2.4	Jun	+ 2.0	+ 2.1	+ 1.6	+ 2.3	May	+ 0.7	+ 2.8	Q1	+ 2.9
Germany	+ 1.7	Jun	+ 1.0	+ 1.6	+ 1.2	+ 3.5	Jun	nil	+ 1.1	Apr	+ 3.3
Italy	+ 2.4	Jun	+ 2.7	+ 2.2	+ 2.1	+ 2.9	May	+ 1.6	+ 3.3	May	+ 1.7
Japan	– 0.5	May	– 0.2	– 0.1	+ 0.2	+ 1.4	Jun	– 1.1	+ 1.2	May	+ 2.4
Netherlands	+ 1.4	Jun	+ 1.9	+ 1.5	+ 1.4	+ 4.0	May	+ 0.6	+ 1.5	Jun	+ 2.9
Spain	+ 3.5	Jun	+ 2.8	+ 2.8	+ 2.6	+ 3.8	May	+ 0.7	+ 3.2	Q1	+ 4.9
Sweden	+ 0.5	Jun	+ 1.8	+ 0.9	+ 1.6	+ 1.2	May	– 1.4	+ 1.5	Apr	+ 3.1
Switzerland	+ 1.1	Jun	+ 0.6	+ 0.7	+ 1.1	+ 1.4	May	– 0.5	+ 1.4	2003	+ 1.8
United States	+ 3.1	May	+ 2.1	+ 2.5	+ 2.2	+ 4.9	May	+ 2.4	+ 2.0	Jun	+ 2.7
Euro area	+ 2.4	Jun	+ 1.9	+ 2.0	+ 1.7	+ 2.4	May	+ 1.4	+ 2.3	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.1	Jun	+ 0.8	na	na	+ 1.6	May	– 0.7	+ 4.1	Q1	+ 4.1
Greece	+ 2.8	Jun	+ 3.8	na	na	+ 3.1	May	+ 2.4	na		na
Iceland	+ 3.6	Jul	+ 1.6	na	na	+ 5.0	Jun	+ 3.2	+ 4.6	May	+ 5.6
Ireland	+ 2.3	Jun	+ 3.5	na	na	– 0.1	May	–10.0	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.6	Jun	+ 1.8	na	na	+ 5.8	Apr	+ 1.7	– 0.4	Dec	+ 0.7
New Zealand	+ 2.4	Q2	+ 1.5	na	na	– 0.6	Q1	– 1.3	+ 2.2	Q1	+ 2.3
Norway	+ 1.3	Jun	+ 1.7	na	na	+12.0	Jun	+ 2.8	+ 4.6	Q1	+ 5.3
Portugal	+ 2.7	Jun	+ 3.3	na	na	+ 1.8	May	+ 1.1	+ 1.3	May	– 1.9

*New series. RPI inflation rate 3.0% in Jun. †Mar-May.

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Portfolio poll

Jul 15th 2004
From The Economist print edition

Portfolio poll

2nd quarter 2004

▼▲ A change of 5% points or more on previous quarter
▼▲ A change of less than 5% points on previous quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Credit Suisse PB	33 ▲	35 ▲	32† ▼	56 ▲	0 ▼	0	21 ▼	3 ▼	8 ▼	12 ▼
Henderson	60	30 ▲	10 ▼	50 ▼	3	7 ▼	18 ▲	3	15	4 ▲
Julius Baer PB	42 ▼	37	21‡ ▲	43 ▲	2	3 ▼	30 ▲	3 ▼	12 ▼	7 ▼
IPM-First Quadrant	45 ▼	55 ▲	0 ▲	53 ▼	5	3 ▲	14 ▲	5 ▼	17 ▲	3 ▼
Lehman Brothers	70	30	0	44	0	5	22	7	13	9
Robeco Group	53 ▼	45	2 ▲	52 ▲	2 ▼	11 ▲	14 ▼	5 ▲	12 ▼	4 ▼
Average	51 ▼	39	10 ▲	50 ▲	2 ▼	5 ▼	20 ▲	3 ▼	13 ▼	7 ▼
Neutral*				55 ▲	3	11 ▼	14 ▼	5 ▲	10 ▲	2 ▼

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro area	Others
Credit Suisse PB	89 ▼	0	0	11 ▲	0
Henderson	15	30	5	50	0
Julius Baer PB	88	0	0	7	5
IPM-First Quadrant	39 ▲	35 ▼	0 ▼	24 ▼	2 ▲
Lehman Brothers	36 ▼	13 ▼	4 ▼	35 ▲	12 ▲
Robeco Group	45 ▲	10 ▼	12 ▲	31 ▼	2 ▲
Average	52 ▲	15 ▼	3 ▼	26 ▼	4 ▲
Neutral*	20 ▼	29 ▼	5 ▼	40 ▲	6 ▲

*Morgan Stanley Capital International (developed) world equity index; Citigroup world government-bond index

†Of which 16% invested in alternative investments

‡Of which 11% invested in alternative investments

Our money managers failed to agree on much this quarter, other than that the bond market remains mostly a safe bet. The path of the dollar was one source of disagreement—Informed Portfolio Management (IPM) and Robeco Group bought dollar-denominated bonds, while Lehman Brothers and Credit Suisse dumped them. There was little movement on bonds of other major currencies, though three of our money managers trimmed their holdings of yen-denominated bonds. Views on American equities were mixed: Credit Suisse boosted its already hefty holdings by more than five percentage points, but Henderson and IPM sold. Four of our six money managers were bullish on European equities. Overall, however, equities lost favour: three of our portfolio managers shifted their exposure from equities into cash. Only Credit Suisse and Henderson reduced their cash holdings.

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Money and interest rates

Jul 15th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 14th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.3	+10.3	May	5.45	4.73	5.20	5.72	5.36	6.52
Britain	+ 5.3	+ 7.8	May	4.80	3.38	4.81	5.10	4.33	5.86
Canada	+12.4	+ 8.6	May	2.03	2.84	3.19	4.82	4.82	6.30
Denmark	+ 7.9	+ 9.0	May	2.25	2.25	2.51	4.36	4.15	5.41
Japan	+ 3.6	+ 1.8	Jun	0.03	0.01	0.15	1.74	1.03	1.86
Sweden	+ 0.7	+ 3.7	May	1.98	2.66	2.86	4.51	4.33	2.94
Switzerland	+ 9.4	+ 4.3	May	0.49	0.29	1.20	2.81	2.39	2.54
United States	+ 5.1	+ 5.5	May	1.46	1.00	2.59	4.48	3.94	5.96
Euro area†	+ 9.3	+ 4.7	May	2.12	2.13	2.53	4.22	3.93	4.03

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.22%, Japan No. 261 1.77%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jul 15th 2004
From The Economist print edition

1995=100

	Jul 6th	Jul 13th*	% change on one month	% change on one year
Dollar index				
All items	96.4	95.3	+ 1.7	+25.3
Food	94.0	91.8	– 0.3	+22.5
Industrials				
All	99.7	100.1	+ 4.2	+29.0
Nfa†	92.0	91.8	– 2.5	+15.4
Metals	106.1	107.1	+ 9.8	+41.0
Sterling index				
All items	82.7	81.0	– 0.4	+ 8.2
Euro index				
All items	103.3	101.7	– 0.4	+14.3
Yen index				
All items	112.1	110.7	+ 0.8	+16.5
Gold				
$ per oz	391.15	401.45	+ 3.9	+16.5
West Texas Intermediate				
$ per barrel	39.65	39.51	+ 6.4	+25.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jul 15th 2004
From The Economist print edition

Market indices

	Jul 14th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,524.1	3,562.8	3,274.9	– 1.0	– 1.1	+ 6.6	+ 2.5
Austria (ATX)	2,007.9	2,030.5	1,568.9	+ 0.5	– 1.1	+29.9	+27.7
Belgium (Bel 20)	2,465.1	2,517.3	2,244.2	+ 0.5	–33.0	+ 9.8	+ 7.9
Britain (FTSE 100)	4,372.6	4,575.7	4,309.4	+ 0.3	–36.9	– 2.3	+ 1.3
Canada (Toronto Composite)	8,458.3	8,898.8	8,123.5	– 0.3	–25.7	+ 2.9	+ 0.8
Denmark (KBX)	238.8	241.3	219.0	– 0.5	–20.9	+11.8	+10.0
France (SBF 250)	2,492.4	2,594.4	2,411.5	– 0.5	–43.2	+ 3.4	+ 1.5
(CAC 40)	3,648.8	3,811.4	3,465.3	– 0.3	–47.3	+ 2.6	+ 0.8
Germany (DAX)	3,898.8	4,151.8	3,726.1	– 0.8	–51.7	– 1.7	– 3.4
Italy (BCI)	1,301.1	1,340.3	1,239.5	– 0.8	–40.4	+ 3.5	+ 1.7
Japan (Nikkei 225)	11,356.7	12,163.9	10,365.4	– 0.2	–70.8	+ 6.4	+ 4.5
(Topix)	1,151.5	1,217.9	1,022.6	+ 1.0	–60.1	+10.3	+ 8.4
Netherlands (AEX)	332.7	364.8	323.0	– 0.6	–52.6	– 1.5	– 3.2
Spain (Madrid SE)	848.1	881.7	808.0	– 0.2	–26.0	+ 5.0	+ 3.1
Sweden (Affarsvarlden Gen)	201.3	218.1	188.5	– 0.5	–49.7	+ 6.9	+ 3.8
Switzerland (Swiss Market)	5,548.3	5,934.4	5,469.0	+ 0.1	–34.0	+ 1.1	+ 1.8
United States (DJIA)	10,208.8	10,737.7	9,906.9	– 0.3	–12.9	– 2.3	– 2.3
(S&P 500)	1,111.5	1,157.8	1,084.1	– 0.6	–27.2	nil	nil
(NASDAQ Comp)	1,914.9	2,153.8	1,876.6	– 2.6	–62.1	– 4.4	– 4.4
Europe (FTSE Eurotop 300)*	980.1	1,026.2	957.9	– 0.2	–42.5	+ 2.3	+ 0.5
Euro area (FTSE Ebloc 100)*	833.3	888.3	806.7	– 0.4	–46.3	+ 0.2	– 1.6
World (MSCI)†	1,044.7	1,085.8	997.0	– 0.4	–27.9	+ 0.8	+ 0.8
World bond market (Citigroup)‡	602.5	619.5	575.1	– 0.1	– 2.8	– 0.2	– 0.2

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jul 15th 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Jul 14th	year ago	Currency units per $ Jul 14th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.6	May	− 33.0	Q1	− 5.3	− 4.7	85.0	83.0	1.38	1.52	2.56	1.71	1.27	0.5
Austria	− 0.5	Apr	− 1.4	Apr	− 0.4	− 0.5	103.0§	103.0	0.81	0.89	1.50	–	0.74	-1.3
Belgium	+ 21.8	Apr	+ 12.2	Mar	+ 3.4	+ 3.5	103.0§	103.4	0.81	0.89	1.50	–	0.74	-0.2
Britain	− 91.3	May	− 39.2	Q1	− 2.6	− 2.6	105.8	98.7	0.54	0.63	–	0.67	0.49	-2.9
Canada	+ 46.7	May	+ 20.9	Q1	+ 2.4	+ 1.8	87.3	84.4	1.32	1.39	2.45	1.64	1.21	1.2
Denmark	+ 9.2	Apr	+ 6.9	May	+ 2.5	+ 2.4	106.6	106.3	6.00	6.63	11.1	7.44	5.50	0.9
France	+ 4.4	May	+ 10.5	Apr	+ 0.8	+ 0.8	106.5§	106.8	0.81	0.89	1.50	–	0.74	-3.8
Germany	+179.6	May	+ 81.3	May	+ 2.6	+ 2.6	104.2§	104.5	0.81	0.89	1.50	–	0.74	-3.7
Italy	+ 2.6	Apr	− 16.2	Apr	− 0.9	− 0.8	76.0§	76.1	0.81	0.89	1.50	–	0.74	-3.1
Japan	+124.5	May	+160.7	May	+ 3.4	+ 3.4	134.0	129.8	109	118	202	135	–	-7.1
Netherlands	+ 33.1	Apr	+ 18.7	Q1	+ 2.8	+ 2.9	102.5§	102.9	0.81	0.89	1.50	–	0.74	-3.1
Spain	− 58.7	Apr	− 27.0	Mar	− 2.9	− 3.1	77.1§	77.4	0.81	0.89	1.50	–	0.74	0.3
Sweden	+ 21.7	May	+ 21.2	Q1	+ 6.3	+ 6.0	81.0	80.5	7.41	8.17	13.8	9.18	6.80	0.2
Switzerland	+ 7.8	May	+ 37.5	Q4	+10.8	+10.6	114.1	111.7	1.23	1.38	2.28	1.52	1.13	-1.6
United States	−572.9	May	−537.3	Q1	− 5.2	− 5.0	95.9	104.5	–	–	1.86	1.24	0.92	-4.7
Euro area	+103.0	Apr	+ 52.8	Apr	+ 0.5	+ 0.5	90.7	89.6	0.81	0.89	1.50	–	0.74	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.0	May	+ 10.2	May	na	na	82.0§	82.2	0.83	0.89	1.54	–	0.76	1.6
Greece	− 27.2	Apr	− 10.4	Apr	na	na	59.5§	59.7	0.83	0.89	1.54	–	0.76	-3.2
Iceland	− 0.3	May	− 0.7	Q1	na	na	95.2**	98.2	71.2	77.6	132	88.2	65.3	0.2
Ireland	+ 42.7	Apr	− 2.1	Q1	na	na	94.2§	95.5	0.83	0.89	1.54	–	0.76	-0.5
Luxembourg	− 3.9	Apr	+ 3.2	Q1	na	na	103.0§	103.4	0.83	0.89	1.54	–	0.76	-1.8
New Zealand	− 2.1	May	− 3.4	Q1	na	na	103.5	99.8	1.53	1.71	2.84	1.90	1.40	2.9
Norway	+ 28.6	May	+ 28.9	Apr	na	na	94.8	96.0	6.86	7.45	12.7	8.50	6.29	10.4
Portugal	− 14.9	Apr	− 8.3	Apr	na	na	93.3**	92.9	0.83	0.89	1.54	–	0.76	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, May average. ‡OECD forecast. **IMF, April average.

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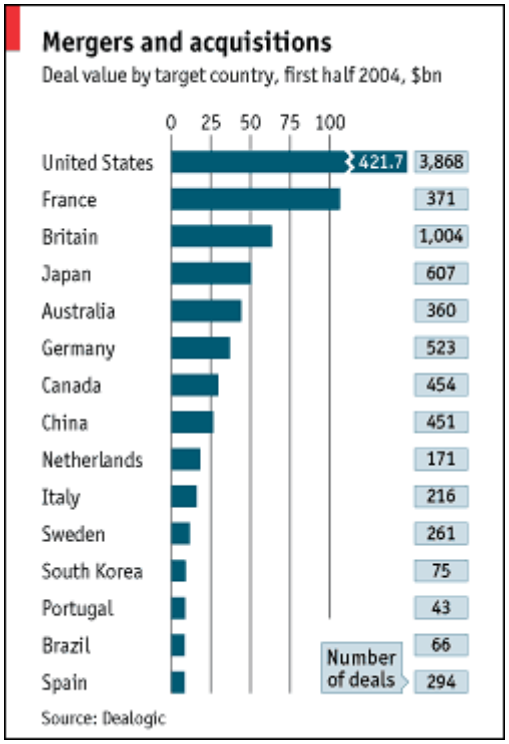
Mergers and acquisitions

Jul 15th 2004
From The Economist print edition



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Overview

Jul 15th 2004
From The Economist print edition

China's economy is showing signs of gradual cooling. Industrial output grew by 16.2% in the year to June, down from 17.5% in the year to May.

Singapore's economy, by contrast, is hotting up. GDP rose by 11.7% in the year to the second quarter, the fastest pace of growth since 1996 and much stronger than the 7.4% GDP growth recorded in the 12 months to the first quarter.

Industrial-output growth in **Mexico** slowed to 2.1% in the year to May.

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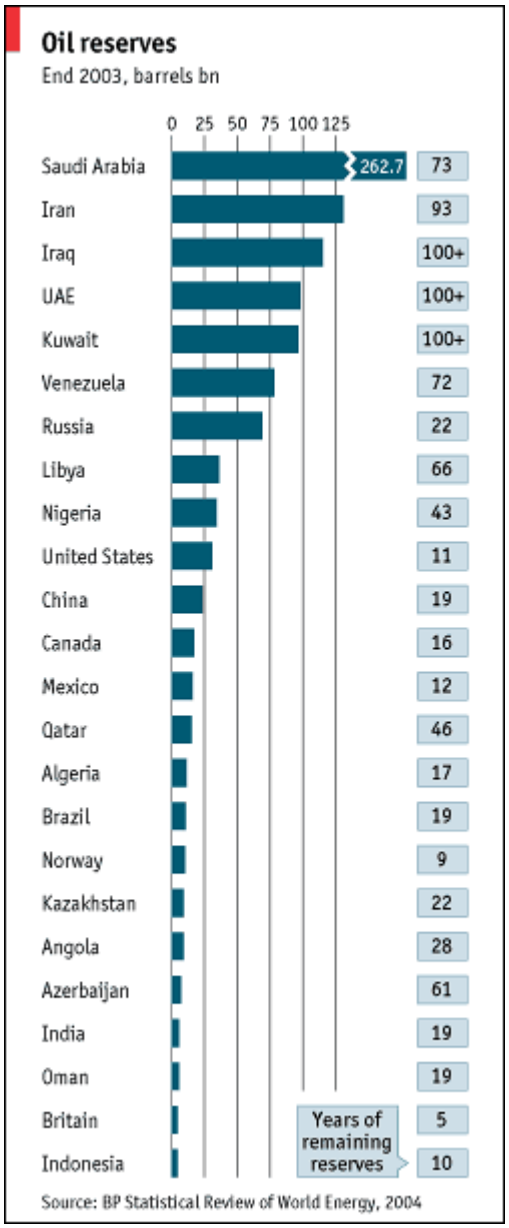
Oil reserves

Jul 15th 2004
From The Economist print edition

In this year's BP Statistical Review of World Energy, the energy giant raises its estimate of global oil reserves only slightly over last year, to 1.15 trillion barrels. Persian Gulf countries retain their dominant position. Saudi Arabia holds sway over 263 billion barrels of oil, about a quarter of world reserves, while four of its neighbours—Iran, Iraq, the United Arab Emirates and Kuwait—each claim around a tenth of the global total.



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Economy

Jul 15th 2004
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	% change on year ago						Latest 12 months, $bn		Foreign reserves* $bn, latest
	GDP		Industrial production		Consumer prices		Trade balance	Current account	
China	+ 9.8	Q1	+16.2	Jun	+ 4.4	May	+15.3 Jun	+45.9 2003	453.5 Apr
Hong Kong	+ 6.8	Q1	+ 1.8	Q1	– 0.9	May	–12.3 May	+14.3 Q1	120.8 Jun
India	+ 8.2	Q1	+ 6.2	May	+ 2.8	May	–16.4 May	+ 8.7 Q1	114.1 Jun
Indonesia	+ 4.5	Q1	+17.1	Apr	+ 6.8	Jun	+27.8 May	+ 7.4 Q4	35.3 May
Malaysia	+ 7.6	Q1	+12.8	May	+ 1.3	Jun	+20.1 May	+13.0 Q1	53.9 Jun
Philippines	+ 6.4	Q1	– 5.2	Apr	+ 5.1	Jun	– 1.7 Apr	+ 3.9 Mar	13.0 Jun
Singapore	+11.7	Q2	+21.0	May	+ 2.0	May	+15.1 May	+27.6 Q1	101.6 Jun
South Korea	+ 5.3	Q1	+13.5	May	+ 3.6	Jun	+27.5 Jun	+24.1 May	166.5 May
Taiwan	+ 6.3	Q1	+16.6	May	+ 1.8	Jun	+13.1 Jun	+27.4 Q1	230.1 Jun
Thailand	+ 6.5	Q1	+ 6.8	May	+ 3.0	Jun	+ 2.2 May	+ 7.4 May	41.8 May
Argentina	+10.7	Q1	+ 6.2	May	+ 4.9	Jun	+14.2 May	+ 6.1 Q1	17.4 Jun
Brazil	+ 2.7	Q1	+ 7.8	May	+ 6.6	Jun	+29.5 Jun	+ 6.5 May	50.5 May
Chile	+ 4.8	Q1	+ 4.5	May	+ 1.1	Jun	+ 6.2 Jun	– 0.1 Q1	61.1 May
Colombia	+ 3.8	Q1	+ 3.8	Apr	+ 6.1	Jun	+ 0.2 Apr	– 1.6 Q1	11.6 Jun
Mexico	+ 3.7	Q1	+ 2.1	May	+ 4.4	Jun	– 5.4 May	– 9.1 Q1	60.3 May
Peru	+ 3.3	Apr	+ 5.6	Apr	+ 4.3	Jun	+ 1.5 May	– 0.6 Q1	10.4 May
Venezuela	+29.8	Q1	+24.6	Apr	+22.3	Jun	+17.8 Q1	+12.3 Q1	18.9 May
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.7 Q1	+ 3.9 Q1	13.6 Feb
Israel	+ 2.6	Q1	– 0.5	Apr	– 0.6	May	– 5.6 Jun	+ 0.3 Q1	26.1 Jun
South Africa	+ 1.9	Q1	+ 3.0	May	+ 0.6	May	+ 1.1 May	– 2.0 Q1	9.8 Jun
Turkey	+10.1	Q1	+16.5	May	+ 8.9	Jun	–26.8 Apr	– 9.8 Apr	33.2 May
Czech Republic	+ 3.1	Q1	+12.7	May	+ 2.9	Jun	– 2.5 May	– 6.0 Q1	26.5 Jun
Hungary	+ 4.2	Q1	+ 7.1	May	+ 7.5	Jun	– 4.2 Apr	– 7.1 Apr	12.6 Jun
Poland	+ 6.9	Q1	+12.3	May	+ 4.4	Jun	– 6.0 Apr	– 2.8 May	35.3 May
Russia	+ 7.4	Q1	+ 5.5	May	+10.2	Jun	+65.7 Apr	+35.3 Q1	81.5 Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+ 6.8	Q1	+ 7.9	May	+ 3.7	May	– 2.2 Apr	– 1.1 Q1	1.4 May
Latvia	+ 8.8	Q1	+ 9.4	Apr	+ 6.2	May	– 2.3 Apr	– 1.3 Apr	1.5 May
Lithuania	+ 7.7	Q1	na		+ 1.1	Jun	– 2.9 Apr	– 1.5 Q1	3.4 May
Slovakia	+ 5.5	Q1	+ 8.0	May	+ 8.1	Jun	– 0.4 Apr	nil Mar	13.1 May
Slovenia	+ 3.7	Q1	– 0.9	Apr	+ 3.9	Jun	– 0.9 May‡	– 0.1 Apr	8.2 Apr
Pakistan	+ 5.1	2003†	+13.4	Feb	+ 8.5	Jun	– 3.2 Jun	+ 2.4 Q1	11.1 May
Saudi Arabia	+ 7.2	2003	na		+ 0.6	Apr	+61.2 2003	+29.7 2003	23.2 May

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Jul 15th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 14th		Dec 31st 2003	
	Jul 14th	year ago	Jul 14th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.4	2.90	1,473.6	– 2.4	– 6.1	– 6.1
Hong Kong	7.80	7.80	14.5	0.37	11,932.8	– 3.1	– 5.1	– 5.6
India	45.9	46.2	85.3	4.49	4,848.3	– 2.2	– 17.0	– 17.5
Indonesia	8,960	8,234	16,632	7.54	744.3	– 3.5	+ 7.6	+ 1.1
Malaysia	3.80	3.80	7.05	2.87	845.0	– 1.2	+ 6.4	+ 6.4
Philippines	55.9	53.4	103.8	7.94	1,565.3	– 2.1	+ 8.5	+ 7.7
Singapore	1.70	1.76	3.16	0.94	1,870.9	– 0.2	+ 6.0	+ 5.7
South Korea	1,153	1,177	2,139	3.91	736.6	– 3.3	– 9.1	– 6.1
Taiwan	33.7	34.4	62.5	1.10	5,623.7	– 1.8	– 4.5	– 3.8
Thailand	40.8	41.7	75.7	1.37	652.8	– 2.0	– 15.5	– 17.8
Argentina	2.95	2.77	5.47	5.06	972.4	+ 0.2	– 9.3	– 9.7
Brazil	3.02	2.86	5.61	15.78	21,672.7	+ 2.4	– 2.5	– 7.0
Chile	631	698	1,172	1.80	7,677.4	+ 0.9	+ 4.6	– 1.8
Colombia	2,662	2,889	4,942	7.89	3,009.7	+ 1.2	+ 29.0	+ 34.7
Mexico	11.5	10.4	21.3	6.69	9,843.0	– 2.0	+ 11.9	+ 9.7
Peru	3.44	3.47	6.38	2.53	2,883.2	– 0.5	+ 18.4	+ 19.4
Venezuela	2,602§	1,598	4,830	16.26	25,364.4	+ 2.1	+ 14.2	+ 25.2
Egypt	6.21	6.10	11.52	11.08	15,291.1	+ 4.4	+ 31.4	+ 30.5
Israel	4.50	4.44	8.34	1.00	585.9	– 1.9	+ 9.6	+ 7.2
South Africa	6.05	7.80	11.2	8.20	10,099.3	+ 0.6	– 2.8	+ 7.4
Turkey	1,432,500	1,390,000	2,659,150	25.18	18,635.2	+ 1.8	+ 0.1	– 1.9
Czech Republic	25.4	28.5	47.1	2.46	787.5	– 0.3	+ 19.5	+ 20.9
Hungary	201	234	374	11.45	11,578.5	– 1.5	+ 23.4	+ 27.1
Poland	3.59	3.98	6.66	6.37	23,364.6	– 1.7	+ 12.2	+ 17.1
Russia	29.1	30.5	54.0	13.00	588.7‡	+ 2.9	+ 3.2	+ 3.8
EMF (MSCI)*	1.00	1.00	1.86	na	426.4	– 1.3	– 3.7	– 3.7
EMBI+†	1.00	1.00	1.86	na	292.9	+ 0.9	– 0.7	– 0.7

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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